The Rise of Urban Private Enterprises in China: A Study of the Information Technology Sector

by

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Declaration

I hereby declare that this dissertation has never been previously been submitted for any degree, and is the result of my own original research and writing. The dissertation contains no materials previously published or written by another person except where due reference is made in the dissertation itself.

Bennis Wai Yip So
15 March 2001

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Abstract

This dissertation is an extensive study of the rise of urban private enterprises in post-1949 China. It focuses upon the changing relationship between the state and the private sector. As a backdrop to my argumentation, it traces the historical background of the Chinese private economy back through the whole era of the Communist rule and discusses the politico-economic logic of the revival of a private economy after the Mao's era. Based upon my case studies of the private information technology sector in Beijing and Guangzhou, I argue that the theory of "embeddedness" in the literature of economic sociology fails to grasp the dynamics of development of the private enterprises. Instead, I argue that a process of "disembeddedness" is under way in the evolution of the private sector, driven by the impact of overwhelming market forces. I suggest that private enterprises in China have become an autonomous economic force, not at the mercy of the state bureaucracy as previous accounts depicted.

I also argue that the Chinese state can be likened to an "intermediate state" in accordance with the state theory put forward by Peter Evans, because it lacks a consistent performance in economic transformation. It has not yet become a "developmental state" due to a lack of ability to collaborate with the private sector to pursue national development goals. Despite the vast contribution of the private sector to post-Mao economic development, the state and the private entrepreneurs are alienated from each other. I suggest that this has become an obstacle to the subsequent development of the private economy.

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List of Acronyms

BICM	Bureau of Industry and Commerce Management
CAD	Computer-aided Design
CAM	Computer-aided Manufacturing
CAS	Chinese Academy of Sciences
CASS	Chinese Academy of Social Sciences
CCP	Chinese Communist Party
DOE	India's Department of Electronics
ETDZ	Economic and Technology Development Zone
FDI	Foreign Direct Investment
FIC	Federation of Industry and Commerce
GETDZ	Guangzhou Economic and Technology Development Zone
IPO	Initial Public Offering
ISBN	International Standard Book Number
ISP	Internet Service Provider
MITI	Japan's Ministry of International Trade and Industry
NASDAQ	National Association of Securities Dealers Automated Quotations
NHTDZ	New & High Technology Development Zone
PEA	Private Enterprises Association
PPCC	People's Political Consultative Conference
PRC	People's Republic of China
R&D	Research & Development
SEZ	Special Economic Zone
SOE	State-owned Enterprise
S&T	Science and Technology
TSP	Tianhe Scientech Park
U&RI	University and Research Institute
VAT	Value-added Tax
ZSP	Zhongguancun Science Park

Chapter 1: Introduction

This is a study of the political economy of development in a transitional socialist country, China. The study focuses upon the most burgeoning economic sector, indigenous urban private enterprise with a particular focus upon the information technology (IT) industry. The dissertation is framed by corresponding studies from economic sociology, which has produced a considerable number of scholarly works on the Chinese economy.

The revival of a *de novo* private economic sector is one of the hallmarks of reform among the former socialist countries in Eastern Europe and the socialist countries in Asia, namely China and Vietnam. While many foreign observers and scholars were probing into the Chinese reform of a state-dominated ownership system, a quiet revolution involving the resurrection of private ownership exerted a neglected influence upon the economic reform. Since the 1990s, the private sector has gradually grown into a significant powerhouse of Chinese economic growth. According to a recently released report by the World Bank, the private economic sector, which the report refers to as shareholding, foreign and indigenous private firms, including private enterprises falsely registered as collectives, accounted for 33% of GDP in 1998, of which the indigenous private sector already constituted 24%, whereas the state sector was reduced to 37 per cent.[1]

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[1] *A Technical Report: China Private Enterprise Study*, prepared for the International Finance Corporation (IFC), the World Bank and The State Economic and Trade Commission (SETC), the PRC, by the Asia Pacific School of Economics and Management at the Australian National University with the assistance of the China Centre for Economic Research, Peking University, Canberra, January 2000.

The indigenous private firms are officially divided into two types of economic entities: self-employed household firms, the so-called *getihu*, and private enterprises, the so-called *siying qiye*. The former refers to a tiny individual firm that is supposed to employ less than eight persons, while the latter refers to a private firm employing more than seven persons, according to the Provisional Regulations on Private Enterprises promulgated in 1988.[2] By the end of 1999, there were 31 million *getihu*, which employed a total of 60 million persons, and 1.5 million private enterprises, which covered 20 million employees.[3] The private enterprises are the subject of this study, and more specifically the high-tech "knowledge" side of it — the private sector of the IT industry.

Why the IT Industry?

The IT industry is becoming the rocket of a new phase of global economic development, the so-called "New Economy." India is unleashing its long-shackled economy, with the IT sector as the spearhead of growth. This industry just re-engineered the revival of the South Korean economy, after a two-year trauma caused by the Asian financial crisis,[4] and the growth of the industry Korean government support is playing an indispensable part. This recent boom of the IT industry seems to attest to the prediction by Peter Evans that the sector is most likely to be the leading business sector

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[2] The distinction of these two types of firms by this definition is not very true in practice now. I will discuss this issue in Chapters 3 and 5.
[3] *China Daily*, 28 August 2000 (Internet edition: www.chinadaily.com.cn).
[4] Brian Bremner & Moon Ihlwan, "Korea's Digital Quest," *Business Week* (Asian edition), 25 September 2000: 20-5.

in the 21st century with substantial state involvement in shaping the path of industrial transformation.[5]

In China, the IT industry provides a focal point by which not only to examine the changing state-business interplay but also to grasp the trend of development of the private economic sector in this socialist country. The IT industry is a sunrise industry that is relatively free of the old planning system, so that the private sector was better able to burgeon in this industry and to create a larger niche than the overall private sector. Moreover, since the Chinese state realises that technological innovation will serve as a key to sustaining current economic growth, the state's industrial policy is becoming high-tech oriented, with the IT sector at the vanguard of all high-tech sectors and as the focus of the state's support. As the state began boosting the development of private enterprises, it put a higher premium on the high-tech private sector. The recently adopted Tenth Five-Year Economic Plan directs that the government "should create a fair competition environment for all types of enterprises, and support, encourage and guide private and individual firms, ***especially technology-based medium- and small-sized ones***, to develop in a healthy direction. (emphasis added)"[6] It is clear, in short, that the private IT/high-tech enterprises enjoy higher status among all types of private firms.

The IT industry is cultivating a new generation of entrepreneurs, some of whom are already millionaires today.[7] They are of the type whose success promotes the legitimacy of private ownership among the communist government and a people

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[5] Peter Evans, *Embedded Autonomy: State and Industrial Transformation* (Princeton: Princeton University Press, 1995), 11.

[6] See the full text of the Plan from *Renmin ribao* [People's Daily], 19 October 2000: 1.

[7] According to a recently released list of the 50 richest entrepreneurs in China, the core businesses of nine of these entrepreneurs lie in the IT industry. The richest among them is Song Chaodi, ranked as tenth, who is one of the cases in my sample. See *Forbes Global* 3, 24(25 November 2000): 150-9.

imbued with decades of socialist indoctrination. The image of legitimacy held by these entrepreneurs may help to create more room for the rest of private enterprises in other industries. In short, the IT sector becomes an excellent testing ground for us to scrutinise to what extent, at its best, the interaction between the state and the private enterprises is shaping the Chinese economic configuration in the new century.

Methodology

The research was carried out mainly through on-site in-depth interviews with private entrepreneurs. I selected two cities as my field sites: Beijing and Guangzhou. My fieldwork was conducted from May to December 1999. Interviewees were contacted through four sources. The first is through the Internet. Many enterprises in China, especially the IT firms, now have their own websites and I was able to tap these to contact their management for interviews. The second source was through personal connections — accessing interviewees through my friends' acquaintances in Beijing and Guangzhou. Third were institutional referrals, by way of intermediary organisations, especially the administrations of the Tianhe Scientech Park and the Guangzhou Economic and Technology Development Zone in Guangzhou. The fourth source was direct personal approaches to several renowned private enterprises. Among the four methods, enterprises accessed via website searching constitute 80% of the cases in this study.

I completed 50 case studies of enterprises, all of which included interviewing: 26 from Beijing and 24 from Guangzhou. I also chatted with a few businesspeople who refused to be formally interviewed. Among the 50 cases, not all of the interviewees were the chief executive. Sometimes, I interviewed senior managers instead, especially in the cases of large-scale enterprises. But I tried to collect material about the chief executive from the interviewees and other overt sources. (The heads of the large-scale enterprises were often celebrities whom newspapers and magazines had written about extensively.) Notably, too, the interviewed top executives were not necessarily the owners of the companies. An entrepreneur whose company was funded by foreign venture investment was such a case. Another case was an enterprise founded by an interviewed entrepreneur but fully funded by another private capitalist. Among my 50 cases, 42 come from the IT industry and 8 cases come from other industries and provide comparisons and a control in this study.

Most of the interviews were conducted using a tape recorder to enable me to carry out the interviews smoothly. Most businesspeople did not mind speaking into a tape recorder and even took the government to task on tape. The interviewees were questioned along the lines of a semi-structured questionnaire (See Appendix II). I also asked them extra follow-up questions. Most interviews were conducted at the entrepreneurs' offices. Each interview lasted from 45 minutes to 1½ hours. The duration depended upon whether the interviewees were talkative and whether I could explore some extra topics based on what they said. However, sometimes the interviewees were very busy, and so I had to cut the interviews short. Usually, the businesspeople would reject being interviewed if I insisted upon a one-hour interview beforehand. However, when the interviewees found me familiar with their businesses, they often forgot to watch the time, and the interviews could be prolonged. Hence, I tried to familiarise myself with and keep abreast of their part of the IT industry before interviews.

Besides the interviewing, I also have amassed a variety of documentary materials about the private economy, IT industry and related information in China. The data of the 50 cases are not only drawn from the interviews but also from other media, including newspapers, magazines and the Internet. After interviews, I kept abreast of the news of the enterprises and entrepreneurs I studied. Alongside the development of the Internet, I kept observing the up-to-date situation of my cases through visiting their companies' websites and on-line news coverage. This after-fieldwork information has been incorporated into the dissertation.

Concepts, Terminology and the Scope of the Study

According to my original research plan, I only expected to study officially registered indigenous private enterprises, excluding "fake" collectives and foreign-funded private enterprises. However, during my fieldtrip, I found it difficult, without case referrals by the Bureau of Industry and Commerce Management (*Gongshang xingzheng guanliju*), to judge initially whether a firm was a private enterprise. At the beginning of my fieldtrip, whenever I contacted a firm for an interview, I tried to make sure that it was a "private" firm. However, I failed. When I contacted companies for interviews, I noted that my research focused upon "private" enterprises, but I found that the staff was sometimes ignorant of the real registration of their companies. Even when I could talk directly with the owners, the owners sometimes seemed only to hold an ambiguous sense of the nature of their own firms. As a result, I interviewed a number of entrepreneurs whose enterprises were not formally registered as private firms.

The key to this misunderstanding should be attributed to the expressions "*siying*" and "*minying*." Both terms are usually translated as "privately owned." But whereas there is a strict official classification of private enterprises, the businesspeople did not adhere to this. The indigenous privately-owned enterprises should be called "*siying*" according to the official norms. However, more businesspeople now would like to adopt "*minying*" as a label for their enterprises, including the private entrepreneurs who register their firms as collective enterprises: that is, the firms that "put on a red hat" (*dai hong maozi*). This is because *min* could be associated with *renmin* (people). *Minying* can be understood as "people-managed," which sounds better socially and politically in China than "privately-managed" (*siying*). *Si* is associated with *zisi* (selfishness) and collides both with the notion of socialism and with Chinese culture.[8]

However, we should dissociate *siying* from *minying*, albeit the latter encompasses the former. *Minying* is a term now employed to label all enterprises except for the traditional state-run and foreign enterprises. Some *minying* enterprises lie within the category of state ownership. Precisely speaking, the source of their funding is not from individuals but from some non-profit state or semi-state organisations or from other state-owned enterprises. In the case of the IT industry, many of these are "spin-offs" from universities and research institutes.

Unlike the traditional state-run sector, these companies are registered as independent legal entities and are not funded through the state budget. They do not operate under the direction of any economic ministry. They bear the responsibility for their own profits and losses, facing a harder budget constraint than the traditional state

[8] Philip Huang provided the same account of this cultural distinctiveness in Chinese. See his "Biculturality in Modern China and in Chinese Studies," *Modern China* 26, 1 (January, 2000): 4-5.

enterprises. They are basically self-financed and rely upon their retained profit for reinvestment. Some of them are in a mixed ownership involving with private capital investment, so it is now difficult to classify the nature of such enterprises simply by ownership. *Minying* becomes a generic term for the people on the mainland to encapsulate these enterprises.

In addition, due to the inferior status of the indigenous private sector vis-à-vis the public and foreign sectors, while some indigenous private enterprises try to register themselves as collective enterprises, some others try to register themselves as foreign-funded enterprises, the so-called "putting-on-of-a-foreign-hat" (*dai yang maozi*). These enterprises are usually nominally established by overseas Chinese who are acquainted with the real business founders. Starting in the 1980s, many mainland Chinese went overseas to study; and some acquired residency/citizenship abroad. They helped their kith and kin at home to organise *de jure* "foreign-funded" firms. In the 1990s, some of these students started to return to China to seek out business opportunities. Taking advantage of their new identity, their firms could be registered as foreign-funded enterprises and granted preferential treatment. Especially important to them would have been the independent right to export and import.

Besides the problem of phoney public and foreign firms, it should be realised that, as noted above, the capital structure of the indigenous private enterprises has become increasingly complicated. Apart from the state-private mixed ownership, the rapid growth of the indigenous private economy in the 1990s lures foreign companies to seek partnerships not only with the public sector, but also with some outstanding private firms. Some foreign capital has also been injected into the indigenous private sector in the form of venture capital instead of forming joint ventures.

Owing to the above reasons, in the midst of my fieldtrip I decided to open the boundaries of my case selection and to restructure my conception of the parameters of indigenous private enterprises in China today. My belief is that the enterprise cases presented in this dissertation project a relatively accurate image of indigenous private enterprises in China.

To avoid any conceptual and terminological confusion, let me clarify here some terms that have specific definitions in this dissertation.

- Enterprise — known as "*qiye*" in Chinese, refers to all types of business firms, except for the self-employed households (*getihu*).
- Company — known as "*gongsi*" in Chinese, only refers to a limited liability company if it is a privately owned enterprise. In other words, an unincorporated private firm cannot be considered a "company."
- State Enterprise — this generally refers to an enterprise that is owned by the state. In this dissertation, it narrowly refers to a state-owned enterprise that is funded by the state budget and subject to the administrative control of state ministries.
- Public and Non-public Enterprise — the public enterprise category encompasses the state-owned enterprises, the collective enterprises, and shareholding enterprises. The non-public (*feigong*) enterprise is a popular term on the mainland to refer to both officially registered indigenous private firms and foreign funded companies.
- Non-state/*Minying* Enterprise — this category of enterprises consists of the collective, cooperative, shareholding, individual and private, and ***state-owned***

people-managed enterprises.[9] It solely excludes the state-owned state-run enterprises that are funded by the state budget and subject to the administrative control of state ministries. This term originated in the high-tech-IT industry.[10] In order to highlight the distinct feature of this category, I prefer in this dissertation to use *minying* to label the non-state IT/high-tech enterprises. For instance, among my cases in Guangzhou, one is a state-owned spin-off, which can be considered a *minying* enterprise.

Thus, this study of indigenous private enterprises covers the scope of *minying*, beyond the boundary of the "orthodox" private enterprises. Nowadays, many private entrepreneurs in China do not manage an "orthodox" private enterprise. For example, the renowned Harbin-based Orient Group (*Dongfang Jituan*), one of the biggest non-state conglomerates, developed from a village collective construction team in 1978 — now a shareholding company — and is popularly considered a private enterprise. Its president, Zhang Hongwei, is one of the richest entrepreneurs in China. The top IT company, Legend (*Lianxiang*), a spin-off from the Chinese Academy of Sciences (CAS), only having received a loan of 200,000 yuan from the CAS since its founding, claimed itself a state-owned people-managed enterprise before its shareholding

[9] In Corinna-Barbara Francis's study of high-tech industry in China, she referred to all state-owned spin-offs as non-state enterprises. See her "Reproduction of *Danwei* Institutional Feature in the Context of China's Market Economy: The Case of Haidian District's High-Tech Sector," *The China Quarterly*, 147 (September, 1996): 839-59.

[10] This definition is derived from a policy document promulgated in 1993 that aimed to encourage the development of *minying* technology-based enterprises. See *Xinhua yuebao* [New China Monthly], 584 (June, 1993): 42.

transformation in 1999.[11] Its president, Liu Chuanzhi, is also considered a private entrepreneur, and he holds stock in Legend worth many millions of yuan.

The above two cases raise a question. What is a private enterprise and private entrepreneur in the context of China nowadays? In this dissertation, I define a private enterprise as a business venture managed by individual persons who are not subject to any state hierarchical control in their business operations and who assume the role of residual claimants, for a venture that is not funded by the state budget. But a private entrepreneur may not be the owner of an enterprise, albeit s/he is a risk-taker and risk-bearer. Here the private enterprise and the private entrepreneur are two discrete entities. First of all, in a real situation, no matter whether in China or other market economies, ownership and control over operations are often separated in an enterprise. An entrepreneur is not necessarily an investor or an owner of an enterprise. The state can provide some of the capital to support private businesses, like Legend. In this sense, in a state-owned enterprise there may exist a private entrepreneur who assumes the right of operation of the enterprise. Many leased or contracted-out state enterprises are run by such private entrepreneurs. The shareholding state-owned companies are operated by private entrepreneurs who are stockholders of the companies. Different from the factory directors (*changzhang*) of traditional state-run enterprises, these managers need to take business risks and are residual claimants to the enterprises.

It is notable that the private enterprises are not necessarily purely privately-funded enterprises. The initial capital of many private enterprises was drawn from loans

[11] For the development history of Legend, see Qiwen Lu, *China's Leap into the Information Age: Innovation and Organization in the Computer Industry* (New York: Oxford University Press, 2000), 63-103.

provided by various state institutions. They might secure, in varying degrees, other state-controlled resources granted by local governments, like collective assets, land and production plants. Only by employing the above definition, can we elicit the dynamics of the private economic growth.

Prelude

This dissertation will argue that the private sector in China has become increasingly autonomous from the mercy of the state bureaucracy. The evolution of the sector is overwhelmingly determined by market forces. The state, social and cultural institutions only modulate the angle of the development path, and do not play the key role.

Chapter 2: Alternative Approaches to the Growth of the Private Sector: A Critical Review and Framing of Research

Three Explanatory Approaches

The development of private business in post-Mao China did not catch much scholarly attention until the end of the 1980s. The surge of interest at that time could be attributed to the political role of private businesspeople in the Tiananmen Incident in 1989. The economic role of businesspeople remained insignificant compared with the enormous size of the state-owned sector. However, they were a relatively independent group under a Communist regime and academics looked to see whether private business could be one of the ingredients of a hoped-for democracy. Though almost all of the researchers put a "not yet" answer to this question, the issue promoted a wider interest in the private sector's development. Paradoxically, the crisis of 1989 also became a driving force within China in the proliferation of the private sector. It seems that the government attempted to unleash the engine of private economic growth to distract popular attention from political issues and to boost economic development so as to legitimise Communist rule.

There are three broad analytical approaches to the growth of private business in China. These are the central-state approach, the market-transition approach and the clientelist approach. The central-state approach focuses on the role of central policy-making and macro-politics in directing the ebb and flow of the private sector.[1] In this

[1] Dorothy J. Solinger, *Three Visions of Chinese Socialism* (Boulder: Westview Press, 1984); Thomas B. Gold, "Urban Private Business in China," *Studies in Comparative Communism* 22, 2&3 (Sum./Aut., 1989): 187-201; Kristen Parris, "The Rise of Private Business," in Merle Goldman & Roderick

perspective, the growth of the private economy is at the mercy of state reformers who take a liberal approach to its development. However, the uncertainty of the state's policy as well as local bureaucratic predation is counter-effective to further prosperity.[2] From the perspective of institutional economics, Ding Lu stresses that the suppressed market institutions in Deng Xiaoping's China to a certain extent channelled the entrepreneurial resources into capturing artificially advantageous positions under an officially enforced monopoly.[3]

While the central-state approach examines the influence of conscious state actions, the market-transition approach underscores the unintended effects of market reforms. Put forward by Victor Nee, the approach holds to the premise that the adoption of market-oriented reforms creates a favourable environment for the growth of private businesses by reducing the redistributive role of the state. The growth of the private sector in turn facilitates the transition to a full market system by fostering a more competitive environment. The interaction between both sides snowballs into an out-of-plan growth of private business.[4] Despite his emphasis on the significance of the state-imposed market institutions, Lu indicates that the activities of private entrepreneurs in China are incessantly correcting the distorted market and pushing policymakers towards more market-oriented reforms.[5] Akin to the market-transition approach, Richard Smith

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MacFarquhar (eds.), *The Paradox of China's Post Mao Reform* (Cambridge: Harvard University Press, 1999).

[2] Rashid Malik, *Chinese Entrepreneurs in the Economic Development of China* (Westport: Praeger, 1997).

[3] Ding Lu, *Entrepreneurship in Suppressed Markets: Private Sector Experience in China* (New York: Garland, 1994).

[4] See Victor Nee & Rebecca Matthews, "Market Transition and Societal Transformation in Reforming State Socialism," *Annual Review of Sociology* 22 (1996): 425-26.

[5] Ding Lu, op. cit., 107-127.

argues that it is the inexorable failure of market reform within the state sector that enables the private sector to thrive.[6]

Arguing against the decline of bureaucratic power during marketisation, the clientelist approach contends, in scrutinising the frontline relations between street-level bureaucrats and private businesses, that bureaucratic power has not been curtailed by the market-oriented reform. The proliferation of the private sector involves a nexus of political manoeuvres in which the local bureaucracy significantly shapes the process.[7] Along the lines of Andrew Walder, who argues for the prevailing and enduring strength of state/bureaucratic power under the market reforms,[8] the clientelist argument posits that the distributive function of bureaucracy has not ceased, albeit it is declining. The decline in this kind of power does not mean that the bureaucrats have lost all sources of power. They can even make use of decentralisation to exploit other sources of power and advantages. With respect to private economic growth, bureaucracies provide shelters to private businesses, especially under unfavourable political/policy conditions, and commodify the resources they hold in exchange for the latter's tribute to local government coffers. The growth of the private sector arises partly out of an exchange process between favour-seeking businesspeople and benefit-seeking bureaucrats in what

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[6] Richard Smith, "The Chinese Road to Capitalism," *New Left Review*, 199 (May-June, 1993): 55-99.

[7] Ole Bruun, *Business and Bureaucracy in a Chinese City: An Ethnography of Private Business Households in Contemporary China* (Berkeley: Institute of East Asian Studies, University of California, 1993).

[8] Andrew Walder, "Market and Inequality in Transitional Economies: Towards Testable Theories," *American Journal of Sociology* 101, 4 (January, 1996): 1060-1073.

become patron-client relationships. This is not ideal-typical market development that the market-transition arguments would suggest.[9]

The above three approaches are ideal-types, and each focuses on a single theme. While the central-state approach aptly highlights the significance of state policies as a driving force in the ups and downs of the private sector, it cannot explain the spontaneous growth of the private sector, whose development outpaced the limitations placed upon it by central policies from the outset. The market-transition approach is better able to explain the unintended proliferation of the sector, but it portrays a zero-sum game of the market displacing the state, ignoring the significant function of local bureaucratic sponsorship suggested by the clientelist approach. On the other hand, the clientelist approach fails to explain the non-particularistic aspects of private-sector development by ignoring market forces.

Although none of the research publications in the 1990s adopt an ideal-type approach, all of them lean towards one of the three approaches. Willy Kraus leaned towards the central-state approach by scrutinising the changing central policies towards the private economy even while he also drew attention to local spontaneous development.[10] Despite her attention to the informal ties between local bureaucracy and private business in her case studies of Sichuan, Susan Young highlighted the decentralisation policy of the government as the dynamic of private economic growth

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[9] David Wank, "Bureaucratic Patronage and Private Business: Changing Network of Power in Urban China," in Andrew G. Walder (ed.), *The Waning of the Communist State: Economic Origins of Political Decline in China and Hungary* (Berkeley: University of California Press, 1995) and David Wank, *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (Cambridge: Cambridge University Press, 1999).

[10] Willy Kraus, *Private Business in China: Revival between Ideology and Pragmatism* (Honolulu: University of Hawaii Press, 1991).

and emphasised the confrontation between business and bureaucracy.[11] More remote from the central-state approach, some recent studies, usually in sociology, examine the local dynamics of private economic growth and the "bottom-up" pattern of the policy making. From the clientelist perspective, David Wank argues that the "bottom-up" pattern does not necessarily imply market growth at the expense of the state hierarchy. Nor is the relationship between businesspeople and bureaucracy necessarily one of confrontation. Instead his case studies of private trading businesses in the city of Xiamen in Fujian Province unveiled many cases of mutual accommodation and reciprocity through the formation of patron-client ties. Wank further asserts that these ties do not simply fade away with the expansion of market forces.[12]

Likewise, against the Wank's studies conducted at the end of the 1980s, a political scientist, Andrea Roberts, refutes the notion that personal ties with bureaucracy become less useful in the competitive environment of the 1990s. She argues that the accumulated power of the private economy has already formed a force facilitating market-transition, driving the government ultimately to accede to market forces.[13] A non-Western sociologist, Chen Chieh-hsüan, in his recent studies in several prosperous counties in Guangdong Province, holds to the same argument and contends that economic development and marketisation induces a division of labour between the government and business firms. And both the local government and the business

[11] Susan Young, "Private Entrepreneurs and Evolutionary Change in China," in David S. G. Goodman & Beverley Hooper (eds.), *China's Quiet Revolution: New Interactions between State and Society* (Melbourne: Longman Cheshire, 1994) & *Private Business and Economic Reform in China* (Armonk: M.E. Sharpe, 1995).

[12] David Wank, "Bureaucratic Patronage and Private Business: Changing Network of Power in Urban China," op. cit.

[13] Andrea Lynne Robert, *The Political Impact of China's New Private Entrepreneurs*, PhD Dissertation (University of California, Berkeley, 1997).

community have to zero in on their own specialities so as to be able to hasten local economic development hand-in-hand. In this regard, the ties between the government and business firms are based upon a "professional" trust. They should not be confused with "particularistic" personal ties.[14]

The market-transition and the clientelist accounts constitute the two contending models to explain the growth of the private sector in China. Despite debates between the two sides, sometimes each account represents one side of a coin. Wank and Roberts in reality recognised the significance of both personal ties and marketisation. By elaborating on Solinger's argument of the transition from dependent to symbiotic clientelism[15] and by arguing for market-clientelism, Wank recognised that clientelism and marketisation went hand in hand, but he disagreed with the argument of complete erosion of the patron-client relationship due to the growth of the market.[16] Paradoxically, he suggested that the bigger a private enterprise became, the more important bureaucratic support became to it.[17] Thus Wank linked marketisation to clientelism by subsuming the former under the latter. In contrast, Roberts modifies the market-transition account, or what can be labelled a political economy account,[18] by

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[14] Chen Chieh-hsüan, *Taiwan chanye de shehuixue yanjiu* [Studies of Taiwan's Industrial Sociology] (Taipei: Lianjing, 1998).

[15] See Dorothy J. Solinger, "Urban Entrepreneurs and the State: The Merger of State and Society," in Arthur Lewis Rosenbaum (ed.), *State and Society in China: The Consequences of Reform* (Boulder: Westview Press, 1992). In dependent clientelism, private businesspeople as clients depend more upon the support of their patron, the bureaucracy, and the tie is more stable. However, in symbiotic clientelism, both sides are mutually dependent, possibly the patron depends more upon the client in material resources. The tie is more opportunistic. See David Wank, "Bureaucratic Patronage and Private Business: Changing Network of Power in Urban China," op. cit.

[16] See David Wank, "The Institutional Process of Market Clientelism: Guanxi and Private Business in a South China City," *The China Quarterly*, 147 (September, 1996): 836.

[17] See David Wank, "Bureaucratic Patronage and Private Business: Changing Network of Power in Urban China," op. cit., 181.

[18] David Wank refers a similar argument to "political economy" account. See *Commodifying Communism*, op. cit., 26-8.

absorbing personal ties into the operations of market transition. She asserts that the aggregate effect of the common practice of seeking bureaucratic favours is to break the hierarchical bureaucratic control over resource allocation — or in economic terms "market distortions." The informal and even illegal practices generated by personal ties correct this distortion, which is in line with Lu's "distortion-correcting" argument.[19] In fact, the arguments between Wank and Roberts were to a large extent mutually compatible. The difference between both lay in their recognition of the role of personal ties in the market. The market clientelism school perceived it as the embeddedness of clientelism in the market. Clientelism was part of marketisation, so it did not fade away with marketisation.[20] The political economy school perceives it as a generator of the market. It argues that personal ties help generate markets in different fields previously dominated by the administrative hierarchy, but that these ties erode after having broken up the hierarchical allocation system.

However, David Wank in his latest account slightly revises his frame by replacing the word "market" with the word "commercial."[21] "Commercial Clientelism" seems to deny the market reform in China is a true marketisation. It is rather a "commodification" of state resources. Different from marketisation, in commodification the resources are only exchanged dyadically between bureaucrats and entrepreneurs in closed commercial terms. The bureaucratic monopoly over resources thus is not curtailed, in contrast to the marketisation. Wank further suggests that the more

[19] Ding Lu, op. cit.
[20] David Wank, "The Institutional Process of Market Clientelism," op. cit., 836.
[21] David Wank, "Political Sociology and Contemporary China: State-society Images in American China Studies," *Journal of Contemporary China* 7, 18 (July, 1998): 205-227 & *Commodifying Communism*, op. cit.

economically developed an area, the more the large private businesses need to gain access to state resources.[22] He thus argues that economic prosperity brings the bureaucracies and entrepreneurs closer together. Wank now keeps his account distinct from the market-transition/political economy accounts.

At the opposite end of the spectrum, Chen argues for the view that entrepreneurs are becoming more autonomous as the more developed the Chinese economy becomes. Although Chen subscribes to that government and entrepreneurs are mutually dependent, the entrepreneurs are no longer subject to the government control. Furthermore, the local government has to adjust itself to accommodate to the demand of entrepreneurs. The bargaining power of entrepreneurs is sharply enhanced.[23]

The Three Approaches in Changing Contexts

The various arguments to a large extent represent the different dynamics of development in different times and places. Chronologically, the private sector was in a germinal stage until around 1988. Until then a petty private economy of individual producers and vendors constituted the bulk of private activities, which had developed in an unfriendly environment. As a result of its weakness as well as the legacy of ideological discrimination, the private sector was very vulnerable to shifts in state policy. However, the relative success of rural economic reforms and liberalisation fostered strong private businesses in rural areas. Correspondingly, the first wave of foreign writings, which highly depended upon the documents released by the news

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[22] David Wank, "Political Sociology and Contemporary China: State-society Images in American China Studies," op. cit., 222.

[23] Chen Chieh-hsüan, op. cit., 357-66.

media, was sensitive to the state's policy debates and the suppressive aspects of policy implementation, and so leaned towards the central-state approach.[24]

The possibility of fieldwork since the end of the 1980s and vigorous private economic development in the rural areas have turned the academic focus towards the rural private sector. This second wave of work increasingly has focused on the local bureaucracy-business interactions rather than state policy.[25] The take-off of the private sector in urban areas since the 1984 urban reform also drew the attention of a few academics who were conducting field research in Chinese cities.[26] But observers of the urban scene more often have put their efforts into scrutinising the political role of entrepreneurs and of the intermediary organisations that stood between them and the

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[24] Dorothy J. Solinger, *Three Visions of Chinese Socialism* (Boulder: Westview Press, 1984); Linda Hershkovitz, "The Fruits of Ambivalence: China's Urban Individual Economy," *Pacific Affairs* 58, 3 (Fall, 1985): 427-450; Thomas B. Gold, "Urban Private Business in China," op. cit.; Susan Young, "Policy, Practice and the Private Sector in China," *The Australian Journal of Chinese Affairs*, 21 (January, 1989): 57-80; Susan Young, "Wealth but Not Security: Attitude towards Private Business in China in the 1980s," *The Australian Journal of Chinese Affairs*, 25 (January, 1991): 115-137; Willy Kraus, op. cit.

[25] Ole Odgaard, *Private Enterprises in Rural China: Impact on Agriculture and Social Stratification.* (Aldershot, Hants: Avebury, 1992); Yia-ling Liu, "Reform from Below: The Private Economy and Local Politics in the Rural Industrialization of Wenzhou," *The China Quarterly*, 130 (June, 1992): 293-316; Susan Young, "Private Entrepreneurs and Evolutionary Change in China," op. cit. & *Private Business and Economic Reform in China*, op. cit.

[26] Thomas B. Gold, "China's Private Entrepreneurs: Small-scale Private Business Prospers under Socialism," *The China Business Review* 12, 6 (Nov.-Dec., 1985): 46-50; "Urban Private Business in China," op. cit.; "Guerrilla Interviewing among the *Getihu*," in Perry link, Richard Madsen & Paul G. Pickowicz (eds.), *Unofficial China: Popular Culture and Thought in the People's Republic* (Boulder: Westview Press, 1989); "Urban Private Business and China's Reforms," in Richard Baum (ed.), *Reform and Reaction in Post-Mao China: The Road to Tiananmen* (London: Routledge, 1991); Ole Bruun, *Business and Bureaucracy in a Chinese City*, op. cit.; "Political Hierarchy and Private Entrepreneurship in a Chinese Neighborhood," in Andrew G. Walder (ed.), *The Waning of the Communist State* (Berkeley: University of California Press, 1995); David L. Wank, "Private Business, Bureaucracy, and Political Alliance in a Chinese City," *Australian Journal of Chinese Affairs*, 33 (January, 1995): 55-71; "Bureaucratic Patronage and Private Business: Changing Network of Power in Urban China," op. cit.; "The Institutional Process of Market Clientelism: Guanxi and Private Business in a South China City," op. cit.; "Political Sociology and Contemporary China: State-society Images in American China Studies," op. cit.; *Commodifying Communism: Business, Trust, and Politics in a Chinese City*, op. cit.; "Producing Property Rights: Strategies, Networks and Efficiency in Urban China's Nonstate Firms," in Andrew G. Walder & Jean C. Oi (eds.), *Property Rights and Economic Reform in China* (Stanford: Stanford University Press, 1999).

state.[27] Despite the variations in their research agendas, one common point that both rural and urban studies caught was the significance of informal vertical ties between bureaucrats and private businesspeople. This helped to explain (1) why the private sector could grow beyond the limits drawn by central state policy; (2) why the sector could carry on through the crisis of 1989; and (3) the operating logic of the private sector in a period of uncertainty.

With the passage of time, difficulties faced by the state sector, and the further legalisation of the private economy, more resources are being left to private control. Its rapid development since 1992 made Victor Nee's market-transition account, which was proposed in 1989, regain momentum, despite a shift in the new arguments.[28] Andrea Roberts' recent PhD research substantiated that personal ties not only were compatible with the market transition but also facilitated the development of market institutions.[29] She explained that the personal exchanges outside the purview of legal institutions were endeavours to enforce market exchanges that were forbidden by the state's discriminatory institutions and policies. The growing predominance of these illegal practices forced the surrender and endorsement of the state to market exchanges. It should be recognised that the private sector nowadays has passed the stage of a struggle for survival. Businesspeople are possibly hesitant to invest but apparently seldom for

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[27] Christopher Earle Nevitt, "Private Business Associations in China: Evidence of Civil Society or Local State Power," *The China Journal*, 36 (July, 1996): 24-43; Kristen Parris, "Private Entrepreneur as Citizen: From Leninism to Corporatism," *China Information* 10, 3/4 (Winter/Spring, 1996): 1-28; Jonathan Unger, " 'Bridges': Private Business, the Chinese Government and the Rise of New Associations," *The China Quarterly*, 147 (September, 1996): 795-819; Margaret Pearson, *China's New Business Elite: The Political Consequences of Economic Reform* (Berkeley: University of California Press, 1997).

[28] See Victor Nee, "A Theory of Market Transition: From Redistribution to Markets in State Socialism," *American Sociological Review* 54, 5 (October, 1989): 663-81.

[29] Andrea Lynne Robert, op. cit.

political reasons. They are no longer so evidently at the mercy of bureaucracy. They now hold less the image of victims and instead an image of being the greatest beneficiaries of the reform. If anything possibly imperils them, it is the underdevelopment of the formal institutions that would ensure a stable and predictable business environment for the private entrepreneurs.

Despite the newly gained momentum of the market-transition approach, the recent attempts tended to incorporate the clientelist arguments into the market-transition account.[30] Now the debate is not whether informal linkages function during the period of marketisation, but rather a question of the nature and functions of the informal linkages. Yet the attempt at a synthesis weakens rather than strengthens the market-transition argument, as the incorporation of informal linkages is regarded as antithetical to the core ideas of the market-transition account.[31] It should be noted that the earliest market-transition hypotheses too optimistically predicted the rapid transformation of the socialist economy into a system imitating the western market. But Chen asserts that while marketisation is indeed significantly transforming the pre-reform socio-economic relationships, sociologists usually disregard the impact of it. The existence of informal linkages should not be considered antithetical to the market, because the linkages are business-oriented as such.[32]

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[30] Victor Nee & Sijin Su, "Institutions, Social Ties, and Commitment in China's Corporatist Transformation," in John McMillan & Barry Naughton (eds.), *Reforming Asian Socialism: The Growth of Market Institutions* (Ann Arbor: The University of Michigan Press, 1996); Yimin Lin, *The Competitive Advantage of Firms after Communism: State and Market in Post-Mao China*, Manuscript (1998).

[31] Xueguang Zhou, "Reply: Beyond the Debate and toward Substantive Institutional Analysis," *American Journal of Sociology* 105, 4 (January 2000): 1175-89.

[32] Chen Chieh-hsüan, op. cit., 348, 357.

The argumentation of the market-transition/political economy account should look more promising due to the state's milestone step of marketisation since the early 1990s. Even the stalwarts of the clientelist account or state-centred approach have recently found the significant dispersal of resources to the private sector by state-sponsored privatisation and the vigorous growth of the private business since the early 1990s.[33] The latest works of Wank still fail to entertain the consequences of the reform after the 1990s.[34] But the clientelist/state-centred viewpoint still enjoys currency among Western academics.

This dissertation constitutes another attempt to examine the relationship between marketisation and informal linkages, and between the state and business at the close of the 1990s. Rather than examine the dyadic state-business linkage, my research goes further to encompass the multiple linkages among businesses (including SOEs and state business agencies) and between businesses and various state administrative agencies.

When there is uneven access to resources in the market, does this imply the functioning of a patron-client relationship or alternatively other business linkages? What networking strategies do entrepreneurs adopt to maximise their edge over their competitors and to minimise the risk/uncertainty of the politico-economic environment? Do the networks and relationships with the state agencies become more formalised and de-personalised? The fundamental question is whether private entrepreneurs manipulate these linkages or are subject to manipulation by these linkages. An answer to such a

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[33] For example, see Jean C. Oi, "The Evolution of Local State Corporatism," in Andrew G. Walder (ed.), *Zouping in Transition: The Process of Reform in Rural North China* (Cambridge: Harvard University Press, 1998); Oi, *Rural China Takes Off: Institutional Foundation of Economic Reform* (Berkeley: University of California Press, 1999).

[34] David Wank, *Commodifying Communism*, op. cit. & "Producing Property Rights: Strategies, Networks and Efficiency in Urban China's Nonstate Firms," op. cit.

question would suggest whether the private sector is liberated from politico-economic control.

Reframing the Research

To answer the above questions, I suggest that we should first reframe the contexts: (1) differentiation among private businesses should be taken into account in further research; (2) the clientelist approach should be sub-categorised; (3) the central-state approach should be reincorporated into the analysis.

Differentiation among Private Businesses

Certainly, after two decades of development, the private sector no longer is a homogeneous group that can be understood by a specific case study. It is now segmented by different sets of conditions, varying according to industry, scale and geography. First, certain industries have been dominated by the private sector, while others are still dominated by the state sector. For example, the service sector is now mostly in private hands,[35] and the competition in it is especially fierce, as entry into the sector is relatively easy and private investment inclines towards this sector.[36] The situation in the manufacturing sectors may not be the same, as the private sector may still be facing unfair competition from the state sector and more regulatory institutions than the service sector. Another source of competition comes from the foreign-invested sector, which dominates the markets of certain industries. Under these circumstances,

[35] Fang Li, *The Social Organization of Entrepreneurship: The Rise of Private Firms in China*, PhD Dissertation (University of Chicago, 1997), 31.
[36] Xia Xiaolin & Li Lulu, "Zhongguo siying gongye qiye: beijing, xianzhuang yu qiantu (shang)" [China's Private Industrial Enterprises: Background, Current Situation and Future (1)], *Gaige* [Reform], 91 (20 July 1998): 116-125.

the private sector may challenge or alternatively accommodate itself to either the ailing old institutions or new institutions. In addition, some industries, like the IT sector studied in this dissertation, have higher barriers to entry in terms of technological or capital requirements. The market uncertainty there is very high. The private businesses in the sector may enjoy specific advantages of flexibility compared to the state sector, but at the same time the private sector may suffer from capital deficiency. The above variations may have different impacts upon the patterns of business/official linkages. Wank's case studies, which only concentrated upon the trading business sector, might only present a small part of the story.

The scale of business is another point of reference. For big businesses, according to Wank's suggestion,[37] government support may become more critical. Despite the fact that most raw materials are available in the market now, supplies of capital, infrastructure, land and other restricted and scarce resources are still highly dependent upon government allocations. By contrast, Ole Bruun perceives that small businesses which do not pursue ambitious growth may be independent of government domination and even resist state predation.[38] Wank has suggested that these small businesses tend to minimise their contact with the bureaucracy and could avoid dependent patron-client ties without switching to symbiotic ones.[39] To what extent are these arguments valid? Do the linkages of the private sector simply follow the logic of Bruun and Wank? Is

[37] David Wank, "Private Business, Bureaucracy, and Political Alliance in a Chinese City," op. cit., 67-8.
[38] Ole Bruun, "Political Hierarchy and Private Entrepreneurship in a Chinese Neighborhood," op. cit.
[39] David Wank, "Private Business, Bureaucracy, and Political Alliance in a Chinese City," op. cit., 67-8; "Bureaucratic Patronage and Private Business: Changing Network of Power in Urban China," op. cit., 180-1.

there any clear distinction between the networking strategies of big and small businesses?

Geographical elements are significant in three dimensions. Due to different physical, cultural and historical backgrounds, different places have different economic development patterns. The distinction between coastal and interior regions is one point of reference; between the north and the south is another. The third dimension is the rural-urban distinction. In terms of private economic development, the coastal and southern regions are well ahead of the interior and northern regions. The rural-urban distinction can be divided into two contrasting aspects. First, it was in the rural areas that the private sector developed the earliest. But the urban areas emulated the rural areas in private economic development during the 1990s. This can be elaborated by way of the spatial mobility of the private sector. Fang Li's research suggests that many of the rural areas come under the tight control of local governments, and that in such districts good personal ties with village or township officials remain crucial.[40] Susan Young observes that the private businesses in rural Sichuan have to assume considerable extra-business social responsibilities.[41]

Despite the persistence of advantageous personal ties, there are alternatives for those having no close personal ties with officials in villages — moving to places favourable to them. As a result, places with more open business opportunities may be able to attract more outside investment. These places are usually urbanised towns and

[40] Fang Li, op. cit., 212.
[41] Susan Young, "Ownership and Community Interests in China's Rural Enterprises," in Kjeld Erik Brødsgaard & David Strand (eds.), *Reconstructuring Twentieth-century China* (Oxford: Oxford University Press, 1998).

cities.[42] This has resulted in a more vigorous development of the urban private sector. In a word, it is relevant to ask whether different economic contexts lead to different configurations in the strategies of private businesses. For entrepreneurs emigrating from rural or other urban areas, is it possible for them to survive without firm, longstanding personal linkages? Do the native entrepreneurs gain a greater edge over non-native ones in business competition?

A main point here is that we have to first differentiate among private businesses before we go on to analyse their behaviour. I will focus upon two particular urban areas — Beijing and Guangzhou — where multiple factors have been juxtaposed in terms of the private economy. Although they both belong among the primary cities of China, they lie respectively in northern and southern China.

Guanxi, Clientelism and Networks

In this study, I deny the assumption of neo-classical economics that portrays markets as loci for randomly distributed buyers and sellers. In fact, there is no perfect business competition in which all entrepreneurs enjoy equal access to information and resources. Those who hold monopoly profits do not voluntarily yield their own profits to other entrepreneurs without a *quid pro quo*. Uneven access to resources is usually the case in a real market situation. The imperfect competition *per se* reflects other mechanisms operating within market institutions.

In China, *guanxi* (personal connections), as a generic concept, is always encapsulated as an informal mechanism of this kind. In Western societies, a similar

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[42] Fang Li, op. cit., 212; Wang Xiaoyi & Zhu Chengbao, *Zhongguo xiangcun de minying qiye yu jiazu jingji* [Private Enterprises and Family Economy in Chinese Countryside] (Taiyuan: Shanxi jingji chubanshe, 1996).

mechanism is called "networks." It includes interpersonal and social relations and habitual connections. The distinction between these two mechanisms is not so clear when they are scrutinised.

However, it is generally assumed that *guanxi* includes some illegitimate or particularistic practices bypassing formal institutions, while "networking" is legitimate albeit informal. Furthermore, *guanxi* is sometimes considered a specific cultural phenomenon in the Chinese community. However, two economists argue that *guanxi* is not a cultural phenomenon in China. Reliance on *guanxi* is because of a lack of a reliable legal recourse. If formal institutions are well established and efficient, a rule-based business governance would replace a relation-based governance.[43] Douglas Guthrie argues by his recent studies of Chinese urban business that *guanxi* should be distinguished from "*guanxi* practice." *Guanxi* only refers to "establishing good business relations" that are universally necessary in the business world. It should not be confused with "*guanxi* practice" that refers to the corrupt practice of "going around the law." He finds that the latter is increasingly taboo for business firms in urban China now.[44] Chen Chieh-hsüan has a similar view. He finds two types of informal business ties: personal and professional. The latter is based upon professional knowledge and past performance in business transactions. He argues that the professional ties will be more prevailing than the personal ties when the economy of a territory is maturing. The former is only significant outside the economic life.[45] It is arguable that *guanxi* may not be

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[43] Shuhe Li & Shaomin Li, "The Economics of Guanxi," (12 July 2000) *China Online* (www.chinaonline.com).
[44] Douglas Guthrie, "The Declining Significance of *Guanxi* in China's Economic Transition," *The China Quarterly*, 154 (June, 1998): 254-82.
[45] Chen Chieh-hsüan, op. cit., 347-8.

distinguishable from "networks." Hence, we had better diversify our understanding of *guanxi*, incorporating it into the analysis of networks and networking.

The network analysis of an economy is greatly influenced by the theory of "social embeddedness of economic behaviour" put forward by Mark Granovetter, who argued that economic modernisation has not created a separate distinguishable economic life as was expected. Economic behaviour remains substantially embedded in the social relationships of the pre-market society.[46] Applied to marketising China, the notion of social embeddedness usually refers to the economic life embedded in pre-reform institutions, like *danwei*, household registration and other hierarchical institutions that facilitate the formation of patron-client ties,[47] and embedded in long lasting social and cultural institutions like kinship and *guanxi*.

In terms of the private economy, David Wank emphasises the persistence of a high degree of embeddedness of private businesses in their clientelist ties with bureaucrats. According to Carl Landé, a patron-client relationship is a vertical dyadic alliance between two persons of unequal status, power or resources that exists for the purpose of exchanging favours and providing mutual assurances of aid between the superior member (patron) and the inferior member (client).[48] In terms of the exchange between a government official and a businessperson, it is taken for granted that the

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[46] Mark Granovetter, "Economic Action and Social Structure: The Problem of Embeddedness," *American Journal of Sociology* 91, 3 (November, 1985): 481-510.

[47] For example, Corinna-Barbara Francis observed that *danwei* system was reproduced among the evolving high-tech enterprises in Beijing. See her "Reproduction of *Danwei* Institutional Features in the Context of China's Market Economy: The Case of Haidian District's High-tech Sector," *The China Quarterly*, 147 (September, 1996): 839-59.

[48] Carl H. Landé, "The Dyadic Basis of Clientelism," in Steffen W. Schmide, Laura Guastic, Carl H. Landé & James C. Scott, *Friends, Followers, and Factions: A Reader in Political Clientelism* (Berkeley: University of California Press, 1977), XX.

former is supposed to be a patron which possesses monopolised resources that the businessperson cannot obtain by himself.

According to this definition, the patron-client relationship covers all reciprocal relationships between persons of unequal status, power and resources. This exchange relation happens everywhere in the world, no matter how a society is transformed. Hence, this definition is too broad to discern the difference between a pre-market and a marketised society if changes really happen. Any bureaucrat-business exchange can be reduced to a patron-client relationship. Therefore, I would add that the existence of patron-client relations between bureaucrats and businesspeople should be so restraining that clients cannot easily get rid of it or seek alternative links. The clients cannot draw key benefits outside their link with patrons, as the clients lack legitimacy out of the link. Fred Riggs terms the businesspeople who live on this relationship as "pariah entrepreneurs."[49] Theoretically, entrepreneurs should tend to want to both reduce dependence and exploit their advantage in retaining important personal ties,[50] unless the economic institution is what Riggs terms a *tributary canteen* where "pariah entrepreneurs" are restrained from making deals outside of the ties.[51]

Transformed from dependent clientelism, Wank's symbiotic clientelism seems to no longer produce a power relationship between patron and client according to my modified definition. We cannot simply say the bureaucrat plays the role of patron due to increasing bureaucrat-business mutual dependence. Victor Nee and Sijin Su also

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[49] Fred W. Riggs, *Administration in Developing Countries: The Theory of Prismatic Society* (Boston: Houghton Miffin Company, 1964).

[50] Wayne E. Baker, "Market Networks and Corporate Behavior," *American Journal of Sociology* 96, 3 (November, 1990): 589-625.

[51] Fred W. Riggs, op. cit., 109.

observed a similar bureaucrat-business relationship in their account, but they just point up the presence of the *guanxi* tie, not the patron-client tie. It is only a horizontal network tie.[52]

Wank also argues that the private sector in China does not become more autonomous from the state sector because of the lack of a clear public-private distinction. I do not think this is an appropriate yardstick by which to measure the degree of autonomy of the private sector. Socialist China was originally a state-owned economic system. How can one expect that a private sector would fully develop from a private sphere which was almost absent in the pre-reform period? Moreover, without mass privatisation as in the East European and former Soviet countries, the state-owned economy continues to prevail in the national economy. Hence, it is inevitable for there to be interplay between the private and public sectors. What we should ask is how the interplay operates. Does it operate according to formal institutions? Can private entrepreneurs make decisions independently, free from political intervention? Is the private sector offered alternatives, not controlled by a specific state business partner? If all of the answers are affirmative, we can conclude that the private sector is gaining an autonomous status from the state, even though various public-private ties are formed.

We should bear in mind that the validity of Wank's thesis of commercial clientelism is based upon the premise that there has been no genuine marketisation in China. If this premise is incorrect, his argument becomes problematic. Some espousers of "social embeddedness" assert that if only a partial marketisation has occurred then

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[52] Victor Nee & Sijin Su, "Institutions, Social Ties, and Commitment in China's Corporatist Transformation," in John McMillan & Barry Naughton (eds.), *Reforming Asian Socialism: The Growth of Market Institutions* (Ann Arbor: The University of Michigan Press, 1996), 123.

the economic behaviour remains highly embedded in the original social and political institutions.[53] In this regard, what we should ask is whether the disembeddedness is in progress or the marketisation is being recaptured by the original institutions, when we now see the economy is partially marketised.

To be sure, it is self-evident that the original institutions would not simply vanish or be incorporated into the evolution of the market. But what we should focus upon is whether economic behaviour is being increasingly swayed by rational economic logic. Refuting Mark Granovetter's "social embeddedness of economic behaviour," Chen Chieh-hsüan employs the Weberian conceptual division between "economic action" and "economically oriented action."[54] Chen argues that the economic action is going to dominate economic life inasmuch as economic life is increasingly independent of other domains. Chen challenges Polanyi's division into "substantive" and "formal" economic activities, among which he upheld the prevalence and magnitude of the former against the latter, as failing to catch the real development trend of modern economic life.[55]

The school of "social embeddedness" has never entertained the social implications of marketisation, as the attention of the school is fully caught by the enduring features of pre-modern/pre-reform society. To ask how marketisation changes social relationships is more important than to ask what original institutions persist.

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[53] For example, see Yanjie Bian and John Logan, "Market Transition and Persistence of Power," *American Sociological Review* vol. 61 (October, 1996): 739-58.

[54] Economically oriented action refers to all types of action influenced by economic considerations, but it includes primarily non-economic action such as political action and all non-peaceful action such as warfare. In the case of China, for example, *guanxi* practice can be considered non-economic action. See Max Weber, *Economy and Society* (Berkeley: University of California Press, 1978), 64-5.

[55] Chen Chieh-hsüan, op. cit., 9.

Without probing this dimension, it is difficult to interpret the dynamics of change. This is the missing link of the "network" approach in the China field.

In Western society, a corresponding debate is framed by asking whether the *laissez-faire* market is regulated by the interventionist state in the post-war period. In his term "embedded liberalism," John Gerard Ruggie argued that the emergence of a hegemonic "liberal" international economic order has been checked by political authorities, which constantly serves social purposes.[56] But Hannes Lacher recently rejoined that the so-called regulated market has not given rise to "embedded liberalism" as it has not rooted out the foundation of the market: the commodification of land, labour and money. Under the logic of the market, he pointed out, "the livelihood of people became dependent on market income, forcing them to behave according to the rationality of the market. The economy became 'disembedded' from the organic whole of pre-capitalist societies."[57] The same process of commodification is happening in China, too. How far does marketisation make the Chinese economic life disembedded from the pre-reform institutions?

Disembeddedness does not refer to a homogenous globalisation of economic institutions. Political and social institutions do play a significant role in coping with the pressures of marketisation. Neil Fligstein suggested that market participants tend to adopt strategies to pursue a more stable and predictable market institution rather than to pursue free competition.[58] On this point, what I stress is that institutional responses to

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[56] John Gerard Ruggie, "International Regimes, Transaction, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36, 2 (Spring, 1982): 379-415.

[57] Hannes Lacher, "Embedded Liberalism, Disembedded Markets: Reconceptualising the Pax Americana," *New Political Economy* 4, 3 (November, 1999): 345.

[58] Neil Fligstein, "Markets as Politics: A Political-Cultural Approach to Market Institutions," *American Sociological Review* 61, 4 (August, 1996): 656-73.

marketisation do not necessarily stem from the pre-set social relations. The responses can be a creative action of entrepreneurs. And business networking is not necessarily equivalent to creating particularistic or patron-client ties.

In addition, in the changing context of recent years, socio-economic relations in China are undergoing a significant transformation. On the one hand, the market-transition approach suggests that businesspeople can get resources from multiple channels of contacts other than the state. Hence, relying upon a strong tie with the government may not guarantee an edge over competitors. On the other hand, the clientelist approach argues that the active involvement of government in promoting the private economy enhances the significance of official ties. But this analysis poses a simple dichotomy between official and non-official ties, and should be subject to debate. First, the bureaucratic system of China has become increasingly fragmented,[59] and so the official ties become more diversified and divergent. The nature and the degree of significance of different government agencies need to be considered. Some government agencies are more concerned with economic development; others more concerned with regulation. Some have nothing to do with business issues; others are very critical for business. Some are concerned with financial extraction; others are not.

Second, the non-official ties cannot simply be categorised as one group. Some non-official organisations have semi-official status, like banks, SOEs, regulatory state corporations, intermediate associations for organising private businesspeople, and labour unions. Some of them are highly concerned with business *per se*. The

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[59]Kenneth G. Lieberthal & David M. Lampton (eds.), *Bureaucracy, Politics, and Decision-making in Post-Mao China* (Berkeley: University of California Press, 1992).

relationship between private enterprises and these organs is fundamentally business-oriented but not absolutely. Furthermore, they have more leverage than average enterprises and sometimes exercise semi-official power. On the other hand, the business linkages with them may be somewhat different than those with state administrative agencies. How we consider their role and nature is also a question subject to research. Should they be regarded as official links or as business links or as hybrid links? How do we account for relationships with these organisations if they are closely related to the growth of a private enterprise?

In any links connected with the above agents or enterprises, some "connections" may be for survival, others for business development. The growth of a private firm may not be concerned with the official/semi-official agencies if the latter are not related to critical allocations of economic resources. The fall of a business may not be attributed to the absence or failure of the official/semi-official connection but the absence or failure of other linkages. Even though the official/semi-official connection is concerned with access to critical resources or the entrepreneur may be well connected with a top leader of the government, a state agency may well be unable to manipulate all variables of business activities. For example, the Ministry of Foreign Trade and Economic Cooperation can control the allocation of permits to export and import, but a connection with it cannot guarantee the sales of a product overseas and minimise other costs of business. In this regard, it should be observed that Wank's analysis and other traditional network analyses are only concerned with a "supply side," neglecting a "demand side" analysis. The "supply side" refers to networking for the access to resource suppliers. The "demand side" refers to networking for product and service delivery. The latter is more important for the survival and success of a business, while the accessibility to production inputs only is pre-requisite to the establishment of the business. No customers or purchasers would care how you gain the production inputs, but they all care whether they buy a good service or product from you.

All in all, the networking is more complicated and multi-dimensional than is usually suggested. Previous studies appear to have simplified or muddled up ill-defined linkages. We are unable to simply account for the success or failure of a business by virtue of only a single official link, even though we can see the existence and significance of the link. Other issues also come to mind in relation to networking. Are the private businesspeople still "pariah entrepreneurs"? Can the official linkages be simply encapsulated as patron-client relationships? Is an official linkage now on average less personalised and more formalised? How should we consider the linkages with semi-official agencies? What networking strategies do private entrepreneurs tend to adopt? What are the most significant linkages of the private sector in their business development? Does the private sector need to secure any other linkages to guarantee the security of their businesses?

Bringing the State Back In

The foregoing sub-section focused upon the informal ties between the bureaucracy and private business. It overlooked impersonal state-business interactions. It should be noted that the institutional adjustments to the building of a "socialist market economy" since 1992 mark a milestone, and state actors have to begin to conform to the rule of a market economy and to build up a favourable legal framework for its operation. In line with this, the Chinese government has avowedly switched from a reluctant encouragement to active promotion of the private economy. Many local governments have formulated policies to promote the private economy and have sought "private" partners in the SOEs' reform. It seems that some regional and local governments are attempting to assume the role of "picking a winner"[60] and to direct private investment,[61] which had previously left them in the lurch. It implies that the state's role in private economic development should be incorporated into the analysis, whereas most previous studies in the market-transition mould and of the clientelist approach simply suppose the state operates as a rent-creator, playing a negative, suppressive but diminishing function or as a personalised body of bureaucracies.

The notion of a beneficial role for the state in economic development is a controversial issue. The paradigm of neo-classical economics plays down the role of the state, while the developmental-state model asserts the state's significant contribution to modernisation, particularly reflected in the countries of East Asia.[62] No matter which argument is more convincing, history shows us that, as Karl Polanyi indicated very early, the state has never been absent from shaping economic activities.[63] The problem is what role the state is playing.

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[60] For example in Zhejiang province, the Bureau of Industry and Commerce Management plans to foster 20 private enterprises to be conglomerates, to foster 20 famous brands of privately-produced commodities, to foster 20 enterprises as big exporters, and to help develop 20 focal private economic zones. See *Dagongbao* [Takungpao] (Hong Kong), 12 November 1998 (Internet edition: www.takungpao.com).

[61] For example, in the name of the Glorious Project, the private entrepreneurs are channelled to invest in poverty-stricken central and western regions. See *China Daily*, 28 November 1998 (Internet edition: www.chinadaily.com.cn).

[62] See Gordon White & Robert Wade, "Developmental States and Markets in East Asia: An Introduction," in Gordon White (ed.), *Developmental States in East Asia* (Houndmills, Basingstoke, Hampshire: Macmillan Press in association with the Institute of Development Studies, University of Sussex, 1988).

[63] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, [1944] 1957).

The post-Mao economic development without "explicit" privatisation seems a miracle to many foreign observers. Compared with the unexpected collapse of the former Soviet Union and with the excruciating misery brought by the post-Soviet marketisation and privatisation programmes that were advised by Western economic experts, the model of China seems to give an alternative and more feasible path of economic transformation for post-communist countries. But some scholars attribute the difference to the "weak" state of Russia and the "strong" state of China.[64] However, the so-called "strong" Chinese state is only referred to the local states of China. Jean Oi's "local state corporatism" and Marc Blecher's and Jane Duckett's "entrepreneurial state" emphasise positive functions of direct economic participation of local governments.[65] Different from the "developmental state" model applied to the East Asian countries, where there is a clear functional distinction between the state and business sectors in a capitalist system, albeit both are closely linked up for pursuing economic development,[66] the local state corporatism/entrepreneurial state is a merger of state and economy in which local government officials engage in entrepreneurial business management (hereafter I use "entrepreneurial state" to encapsulate Oi's "local state corporatism").

However, the "entrepreneurial state" concept has limitations when interpreting the state-society relationship in economic development. First of all, it is not a coherent

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[64] See a literature review from Shu-yun Ma, "Comparing the Russian State and the Chinese State: A Literature Review," *Problems of Post-Communism* 47, 2 (March-April, 2000): 3-12.

[65] See Jean Oi, *Rural China Takes Off*, op. cit.; Marc Blecher, "Development State, Entrepreneurial State: The Political Economy of Socialist Reform in Xinju Municipality and Guanghan Country," in Gordon White (ed.), *The Chinese State in the Era of Economic Reform: The Road to Crisis* (Armonk: M.E. Sharpe, 1991); Jane Duckett, *The Entrepreneurial State in China: Real Estate and Commerce Departments in Reform Era Tianjin* (New York: Routledge, 1998).

[66] See Chalmers Johnson, *MITI and the Japanese Miracle: the Growth of Industrial Policy, 1925-1975* (Stanford: Stanford University Press, 1982).

institution prevailing across the country. Its existence depends upon at least two variables that need to be present simultaneously — a weak local society, and competent and aggressive leaders who are set to assume the entrepreneurial role. A weak society means that the economic components within the society lack an ability to organise and coordinate themselves to achieve the common goal of economic development. Hence it needs a leader as an organiser and coordinator. And this leader is usually the political leader of the society. However, cases were also found that if a society is strong enough to organise economic activities, the entrepreneurial state may not necessarily be the case, like Wenzhou in Zhejiang Province where the indigenous private sector dominates the local economy. In southeast coastal areas, the strong economic linkages with overseas Chinese in society minimise state participation. However, in remote inland villages where the weakness of leadership and society is prevalent, the economic development tends to be inactive.[67]

Second, in light of the state-society dichotomy, the state and society under the entrepreneurial state model highly overlap. Village governments are usually ruled under a one-man leadership, and the leader acts both as the representative of the state and of the social communities.[68] The indistinct boundary between the state and society makes the analysis problematic and irrelevant.

In addition, the entrepreneurial state may be a transitional phase of development. The entrepreneurial state could help the local economy to take off during the infant stage of development, as it is too risky and costly for societal actors to organise and

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[67] These villages are labelled as "paralysed villages" by Kevin O'Brien; see "Implementing Political Reform in China's Villages," *The Australian Journal of Chinese Affairs*, 32 (July, 1994): 51-3.

[68] Xiaolin Pei, "Township-Village Enterprises, Local Governments and Rural Communities: the Chinese Village as a Firm during Economic Transition," *Economics of Transition* 4, 1 (1996): 52.

coordinate the scattered resources. However, it becomes an obstacle to the later stages of development due to the indeterminate property rights system. Hence, it is found that the trend of privatisation has already grown strong enough in rural China to break through the bottleneck.[69] Chen Chieh Hsüan's study substantiates that the separation of government from business is a remarkable trend of economic development in China in which the local economy has passed through the take-off period.[70]

Lastly, Duckett's entrepreneurial state in the urban setting is further detrimental to social interests, as entrepreneurial bureaucracies are simply pure profiteers that are insulated from society, and take advantage of their special positions to pursue personal/departmental interests and to erect barriers of entry to private entrepreneurs. This actually works against the overall interest of national economy.[71] The entrepreneurial state in this sense is only a replication of the bureaucratic-capitalism that had existed under the Kuomintang's rule.

The growth of the private economy gives a better interface for the study of state-society relationship because of the more distinguishable roles between the state and the business sector. Some recent studies have noted that some rural governments switch to playing a "developmental" role in facilitating the growth of the private sector.[72] But it should be noted that the capacity of these lowest-level states to steer development is

[69] See Jean Oi op. cit., 80-94.
[70] Chen Chieh-hsüan, op. cit.
[71] See a review of Duckett's book from Jean-François Huchet, *China Perspectives*, 24 (July-August, 1999): 86-8.
[72] In Marc Blecher's & Vivienne Shue's case studies of Shulu County in Hebei Province, the county government was portrayed as well establishing regulatory institutions for private commercial trade. See *Tethered Deer: Government and Economy in a Chinese County* (Stanford: Stanford University Press, 1996), 135-47. In the latest studies of Xiqiao Township in Guangdong Province done by Jonathan Unger and Anita Chan, it is also found that the local government seeks to nurture private industry. See their "Inheritors of the Boom: Private Enterprise and the Role of Local Government in a Rural South China Township," *The China Journal*, 42 (July, 1999): 45-74.

limited because of deficient expertise and resources. What is more, the authority exercised by the local states was strictly bounded by their feeble administrative power. Only the authority of higher-level government organs can play a linchpin role in readjusting the state-business relationship. The urban setting of this study will provide a better backdrop to examine this issue.

After two decades of reforms, China has entered a post-state-socialist stage in which the market system assumes the dominant role in economic development, albeit with state macro-economic control over the market. China is now more comparable to the newly-industrialised East Asian countries in which the state's participation in the market economy is conspicuous.[73] However, scholarly findings tend to point out that the strength of the Chinese state is declining. Wang Shaoguang and Hu Angang, for instance, argue that the "state capacity" of China has been declining since the reforms.[74] Somewhat along the same line, Shaun Breslin argues that the miracle of Chinese economic development has occurred despite a lack of a systematic formulation of a coherent and effective national economic development strategy. It is a "dysfunctional development."[75] To be sure, the "state" in their definition should be an autonomous entity insulated from society. This stems from a "statist" conception in which a "strong state" refers to the state's ability to devise and implement policies even against the will of major societal actors.

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[73] The involvement of state in the market is usually termed "state intervention." But it is a biased term employed by economists. Hence, I rephrase the term by "state participation."

[74] The "state capacity" they refer to consists of extractive capacity, steering capacity, legitimative capacity and coercive capacity. See Wang Shaoguang & Hu Angang, *Zhongguo guojia nengli baogao* [Report on the China's State Capacity] (Shenyang: Liaoning renmin chubanshe, 1993).

[75] Shaun G. Breslin, "China: Developmental State or Dysfunctional Development," *Third World Quarterly* 17, 4 (December, 1996): 689-706.

Many of the recent writings in development studies pinpoint that a "strong state" in terms of economic development does not lie in the high degree of autonomy of the state. An institutional linkage between the state and society is ultimately necessary. According to the "neo-statism" presented by Linda Weiss and John Hobson, a strong state is a state that can strengthen society and mobilise elite social collaboration in pursuit of development goals.[76] Similarly, Peter Evans contends that the developmental state should not be insulated from society but be embedded in a concrete set of social ties, while it is capable of transcending private interests — i.e. embedded autonomy.[77] Conversely, a "weak" state is so autonomous that it is only able to use its despotic power to extract resources from society but lacks powers to penetrate and centrally coordinate the activities of civil society through its own infrastructure. For the case of East Asian countries, Cal Clark and K. C. Roy conclude that strong states and strong societies both are equally important to the success of their development.[78] In short, successful development rests on the state and society collaborating well with each other in pursuing the goals of economic development. If so, how should we account for the growth of the Chinese private economy? Is China an exceptional case in this perspective? Does "neo-statism" shed light on our understanding of this issue?

The development of the private sector originated from a paradox in which there was both consistency and inconsistency between the state and society. Both sides shared the same goal, that economic modernisation should be given first priority after the

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[76] Linda Weiss & John M. Hobson, *State and Economic Development: A Comparative Historical Analysis* (Cambridge: Polity Press, 1995).
[77] Peter Evans, *Embedded Autonomy: State and Industrial Transformation* (Princeton: Princeton University Press, 1995).
[78] Cal Clark & K.C. Roy, *Comparing Development Patterns in Asia* (Boulder: Lynne Rienner, 1997).

failures of Maoist radicalism. That was the aspect of consistency. However, there was no consensus between them on the means to achieve the goal. The state, in terms of policymaking and corresponding institutions, was not attempting to forge an economic collaboration with the private business. The extraordinary growth of the private sector was indeed a "dysfunctional development" that was not an intention of the state. From the society-centred perspective, as Minxin Pei suggests, the private economic development is a "societal takeover."[79]

With the full legitimatisation of the private sector at the end of the 1990s, the state no longer stands aloof from promoting the private economy. However, is the Chinese state "weak" or "strong" with respect to the development of the private economy? Is the state now building up effective institutional linkages with the business sector? Or does the nature of the state remain predatory and despotic? And if so, can the growth of the private economy maintain in the context of a "weak state and strong society"?

In short, this study is framed to probe the dynamics of private economic development at the end of the 20th century and the start of the 21st through the lens of informal and formal interactions between the state and the private business. What is the nature of evolving state-business linkages now? Do they facilitate or retard a healthy development of the private economy?

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[79] Minxin Pei, *From Reform to Revolution: The Demise of Communism in China and the Soviet Union* (Cambridge: Harvard University Press, 1994).

Chapter 3: Policymaking towards the Private Economy

My fieldwork was conducted in 1999 when the private sector had already developed for two decades. A review of this past development can help us to understand the current situation. This chapter attempts to reconstruct the history of state policy towards the private sector from 1949 to the present time. My key point is that except for the radical period of the Cultural Revolution decade, the Party line towards the private sector has been ambiguous. This ambivalence was a mixed blessing to the private economy, whereas more recently the policy has turned in favour of the private sector due to the adoption of a market economy.

The Private Economy in the Pre-Reform Era[1]

When the Party came to power in 1949, except for the bureaucratic-capitalists closely associated with the Kuomintang regime whose properties were immediately confiscated, the 7.24 million independent private craftsmen, merchants and industrialists in cities and towns retained their businesses.[2] Statistical data about the rural areas is lacking, but it has been estimated that there were 30-40 million people engaged in private business in the entire country.[3] These businesspeople were classified as the national bourgeoisie or petty bourgeoisie, an intermediate force with whom the Party could form a united front to help develop the Chinese economy, based upon the

[1] The argument about the Chinese private economy from 1949 to 1956 is mainly drawn from my Master's thesis. See my, *Elites, Bureaucracy, and the Policy Process in China: A study of the Socialist Transformation of Capitalist Industry and Commerce, 1949-56*, MPhil. Thesis (Hong Kong: University of Hong Kong, 1996).
[2] *Beijing Review* 27, 33 (13 August 1984): 26.
[3] *Beijing Review* 31, 7 & 8 (15-28 February 1988): 15.

moderate line of New Democracy. In accordance with this line, businesspeople were guaranteed that the capitalist economy would be retained, as long as this activity was in accord with state regulations. The private sector was forbidden to engage in businesses concerned with the people's livelihood and key sectors, like banking and heavy industries. There was a consensus among the Party leaders that this "New Democratic" era would last around 10 to 15 years.[4] During the period from 1949 to 1953, private industry witnessed a certain degree of growth under this non-socialist policy. The number of industrial plants increased from approximately 120,000 in 1949 to over 150,000 and employed 2.2 million workers in 1952.[5]

However, in the second half of 1952 Mao Zedong suddenly claimed that China should enter the socialist stage. The socialist policies adopted from 1953 onward included a gradual changeover of the ownership of private enterprises into joint public-private enterprises. There were two reasons for this drastic change. The first was Mao's optimism regarding the capability of the Communist government to run the economy. It was the intrinsic conviction of the Party leaders that the public sector was more advanced than the private sector. The division of opinion lay over when it would be ripe for the former to take over the latter. With the unanticipated early victory of the civil war and the completion of the Land Reform Campaign in 1952, Mao judged that socialism should "become a reality" earlier than the Party leadership previously expected.

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[4] Bo Yibo, *Ruogan zhongda juece yu shijian huigu* [Reflection on Certain Major policy Decisions and Events], vol. 1 (Beijing: Zhonggong zhongyang dangshi chubanshe, 1991), 212-4.

[5] Wang Haibo, *XinZhongguo gongye jingjishi* [History of Industry of New China] (Beijing: Jingji guanli chubanshe, 1994), 207.

The second reason why Mao acted was the incompatibility between planning and the market, and between the state sector and the private sector. Despite its leniency towards the existence of a private economy, the new government was abolishing some of the marketing institutions in order to implement Soviet-like economic planning and was trying to turn the private sector into a subsidiary of the state economy. Even before the change of policy line, private industry was being subjected to indirect control by the state. Private industrial firms increasingly depended upon the state's processing orders. In 1952, 56% of the private industrial output was produced for state contracts.[6] Since the private sector was now serving the state rather than the market, entrepreneurs tended to pursue corrupt "rent-seeking" activities that to a large extent led to the outburst of an anti-corruption campaign in early 1952, namely the Five-Anti Campaign.[7] However, the origin of the corruption was officially attributed to the "evil" attributes of capitalists attempting to attack the proletariat. Mao thus judged in June 1952 that the contradiction between the working class and the national bourgeoisie had become the "principal" contradiction.[8] The campaign more or less swayed the judgement of Mao over the schedule of nationalisation.

In the commercial field, officials from the state trading agencies accused merchants of engaging in speculation and challenging the leadership of the state by competing against the state sector. The merchants usually found themselves without any

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[6] See *Zhonghua renmin gongheguo jingji dang'an ziliao xuanbian* [Selected Economic Archives of the PRC], Industry and Commerce Section: 1949-52 (Beijing: Zhongguo shehui kexue chubanshe, 1993), 739.

[7] The campaign aimed to fight against five "poisons" of the bourgeoisie: bribery, tax evasion, theft of government property, incorrect fulfilment of government jobs and the employment of economic data for private benefit. For the viewpoint about the economic cause of the campaign, see Ding Lu, *Entrepreneurship in Suppressed Markets: Private-Sector Experience in China* (New York: Garland, 1994).

[8] *Selected Works of Mao Tsetung*, vol. 5 (Peking: Foreign Language Press, 1977), 77.

niche to adapt to the new regime, for no matter what business strategy they adopted they came under the suspicion of officials. The state started to replace some of the private commercial sector with state agencies even before 1953, as private commerce was regarded as the most exploitative and "non-productive" sector by the Communists. This early take-over went hand in hand with the implementation of unified purchases of some key materials from 1951 onward. However, due to the incompetence of the state sector to satisfy the daily needs of a scattered, huge population and the difficulty to settle the job placements of enormous numbers of merchants and their employees, the nationalisation and collectivisation of private commerce made no significant progress. The number of commercial firms was only slightly reduced from 4.5 million in 1951 to 4.1 million in 1953.[9] It is interesting to note that the Communist government was never able to fully expunge the commercial and service sector, albeit it was the first sector to be transformed. After the adoption of the reform policy in 1978, the private commercial and service industry was also the first to revive.

Nationalisation and collectivisation — the so-called "socialist transformation" — was swiftly completed under the state's mobilisation. However, when the Party proclaimed that at the Eighth National Congress in 1956, the socialist transformation had been basically completed, a considerable number of private firms remained in place, especially in the commercial sector — respectively 870 industrial and 432,000 commercial concerns.[10] Many "transformed" small shops and traders basically sustained their operations as before without being collectivised or merged into the state sector,

[9] *Zhongguo gongshang xingzheng guanli tongji sishinian* [Forty Years of the Industrial and Commercial Administration of China] (Beijing: Zhongguo tongji chubanshe, 1992), 130.

[10] See *Zhongguo zibenzhuyi gongshangye de shehuizhuyi gaizao* [Socialist Transformation of Chinese Capitalist Industry and Commerce] (Beijing: Renmin chubanshe, 1978), 228-9.

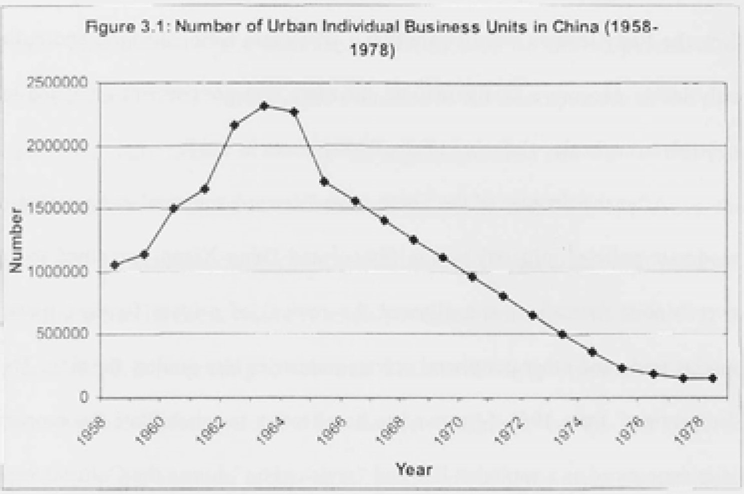
albeit they were relabelled as a joint public-private operation. In fact, not only the sweeping campaign of nationalisation had not thoroughly extinguished the private economy, but also many new private handicraft workshops and small traders revived right after 1956, with around 1.4 million people engaged in the businesses then.[11] In fact, the Party leaders were aware that a wholesale nationalisation and collectivisation only led to excessive amalgamation; therefore, the government switched to loosening controls over the development of small businesses in 1957.

After the disaster of the Great Leap Forward and rural communisation in 1958, moderate policies initiated by Liu Shaoqi and Deng Xiaoping gained the upper hand over Maoist radicalism and allowed the revival of private farming plots, rural free market trade and other peripheral private industries like poultry farming. This policy of "adjustment" from 1961-64 proved to be effective to rehabilitate the economy but was later denounced as a capitalist line and "revisionism" during the Cultural Revolution.

While the private sector rapidly dwindled after 1953, the years from 1957 to the eve of the Cultural Revolution experienced a slight growth of individual businesses. According to the official figures, the number of urban individual business units expanded from 1.06 million in 1958 to 2.27 million in 1964 (See Figure 3.1). However, with the outburst of the Cultural Revolution in 1966 Maoist radicalism dominated the policy line again. In order to cut off "the tails of capitalism" (i.e. remnants of capitalism), almost all markets and private economic practices were prohibited. The size of the individual economy plummeted. On the eve of the reform era, there were approximately only 150,000 individual business units left in urban areas (See Figure

[11] Wang Binglin (ed.), *Zhongguo gongchandang yu siren zibenzhuyi* [the CCP and the Private Capitalism] (Beijing: Beijing shifandaxue chubanshe, 1995), 384-5.

3.1). Nevertheless, it is noteworthy that after the completion of the socialist transformation, the private sector in the form of individual business, later called *getihu*, and even an occasional "underground" enterprise had existed in China.



Sources: compiled from Zhang Houyi & Ming Zhili (eds.), *Zhongguo siying qiye fazhan baogao* (1987-1998) [Report on the Development of China Private Economies (1987-1998)] (Beijing: Shehui kexue wenxian chubanshe, 1999), 92.

The foregoing paragraphs do not aim to review how the private economy waned during the pre-reform era. What I want to emphasise was the inability of the Party to replace the private sector completely with a "bureaucratic economic organisation." To be sure, the level of nationalisation and collectivisation of socialist China was lower than that of the Soviet Union in the sense that most of the labour force in the latter worked in a fully protected state sector, including collective farms, that provided income security, medical care, and other benefits, whereas about 80% of the labour force in China, mainly peasants, received no such benefits from the state.[12] More importantly, the hierarchical control of economic planning in China was never attained to the same extent as in the former Soviet Union, so that out-of-plan economic development triggered by political decentralisation could be rolled out easier in China.[13] By contrast, the decentralisation measures under *perestroika* encountered resistance from local bureaucracies and peasants because the reform infringed upon their vested interests.[14]

The less complete state plan in China might attest to the relative weakness of the Chinese state in the "statist" sense; on the other hand, the spirit of entrepreneurship was not thoroughly extinguished. This "state failure" sowed the seeds for the spontaneous growth of the private sector soon after the end of Mao's rule. At the same time, the Party leaders, especially the liberal wing, were not stalwarts of the Soviet model. They believed that the backwardness of the Chinese economy justified the limited use of markets and material incentives to boost economic development before the completion of economic modernisation. The effectiveness of the policy of "adjustment" in the early 1960s provided Deng Xiaoping with a reasonable basis to employ a similar policy when he came to power in 1978. This liberal tendency of pro-reform leaders facilitated the re-legitimisation of the private sector in the post-Mao era. However, the Party and businesspeople confronted each other again concerning compatibility between the market economy and the planned economy, the same issue that they had failed to settle

[12] Minxin Pei, *From Reform to Revolution: The Demise of Communism in China and the Soviet Union* (Cambridge: Harvard University Press, 1994), 136.

[13] See the comparison of the initial reform economic institutions between China and the Soviet Union from Yingyi Qian and Chenggang Xu, "Why China's Economic Reforms Differ: the M-form Hierarchy and Entry/Expansion of the Non-state Sector," *Economics of Transition* 1, 2 (1993): 135-170.

[14] Minxin Pei, op. cit., 126-7.

during the New Democracy era of the early 1950s. The adoption of reforms in 1978 to a certain extent took China back to the historical scenario of New Democracy or the early 1960s.

Policies in the Post-Mao Era: Crossing the River by Groping for Stones

The development of Party policies towards the private economy during the post-Mao era can be divided into four stages. The period from 1978 to 1987 was one of "toleration," which was simply a continuation of the tolerant policy implemented during the New Democracy era, though the implications were somewhat different. During the years from 1988 to 1991, the policy came across as a "mixed interim." On the one hand, the private economy was formally legalised as an economic component in socialist China. On the other hand, its development suffered due to the 1989 political turmoil. The southern tour of Deng Xiaoping in 1992 resolved the impasse of the ambivalent official attitude towards the private economy and proved a milestone for the subsequent period of rapid growth of the private sector. The years from 1992 to 1997 marked a period of "active promotion." The central and local governments started to hasten the development of the private economy. The reform measures towards SOEs indirectly helped the growth of the private sector. Despite this, it still lacked an equal status with other types of ownership in terms of accessibility to resources and legal protection. But from 1997 onwards, the policy entered into a period of "public-private convergence." At the end of the 1990s, there existed two tendencies in economic policymaking. First, Party policy started to blur the distinction between the public and the private sectors. As the traditional SOEs have obviously lost their competitive edge under the market reform, the private economy is now deemed indispensable to economic development. And the private sector is being merged with state capital, as the state now encourages the development of various types of mixed ownership. Second, economic policies no longer sharply make distinctions according to ownership. Policy is being re-oriented in terms of distinctions by scale of enterprises and types of industries.

Policymaking towards the private economy has been based upon the general reform strategy of "crossing the river by groping for stones" (*mozhe shitou guohe*). It connotes that the reformers did not know which point of the opposite bank they would reach eventually (i.e. the ultimate goal of the reforms), but they knew that they had to "cross the river" (i.e. needed to carry out reforms). Although the ultimate goal was not clear to the reformers at the beginning, the "stones" positioned before them in fact pointed in a definite direction. The closer they approached to the opposite bank, the clearer the goal would be. Under this strategy, policymaking was relatively passive at the beginning and once the goals were made clear, policymaking became more active. Policies towards the private economy followed this line of development from toleration to active promotion.

The Period of Toleration (1978-1987)

Although the Third Plenum of the CCP's Eleventh Central Committee in December 1978 officially marks the beginning of economic reforms,[15] the Plenum made no specific policy concerning the private economy. It only allowed some sideline

[15] But in Lynn T. White's recent work, he substantiates that the economic reform started socially from the early 1970s. See his *Unstately Power Vol. I: Local Causes of China's Economic Reforms* (Armonk: M.E. Sharpe, 1998).

private endeavours within the rural communes and revived rural markets. However, the redirection of the policy line against egalitarianism and towards emphasis upon material incentives and allowing a certain degree of inequality gave impetus to the revival of private business.

To be sure, individual businesses were legitimised as early as 1975 when the Party called for carrying out the Four Modernisations programme.[16] The legal position of individual business was written into the 1975 Constitution where Article 5 read:

> "The state may allow non-agricultural individual labourers to engage in individual labour involving ***no exploitation of others***, within the limits permitted by law and under unified arrangement by neighbourhood organisations in cities and towns or by production teams in rural people's communes. At the same time, these individual labourers should be guided onto the road of ***socialist collectivisation*** step by step (emphasis added)."[17]

This Article was retained basically intact in the 1978 Constitution. But even though individual business was allowed, it had to involve "no exploitation of others." This implied that the hiring of labour might be problematic. More significantly, the direction of individual business still pointed towards "socialist collectivisation." Hence, it was hard to say there was any policy breakthrough at that time.

It was not until 1981 that the government clarified the policy towards individual business. The "Policy Regulations on Urban Non-Agricultural Individual Business" issued by the State Council on July 17, 1981, stipulated that the state protected individual businesses from infringement. In addition, the individual business owner was

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[16] The four aspects of modernisation consisted of agriculture, industry, national defence, and science and technology.

[17] Quoted from Joseph En-pao Wang, *Selected Legal Documents of the People's Republic of China Vol. 1* (Arlington, Virginia: University Publications of America, 1976), 72-3.

allowed to employ one to two helpers and not more than five apprentices with the approval of corresponding state agencies of industrial and commercial administration.[18] It was later stipulated that individual businesses (*getihu*) were those employing fewer than eight persons, whereas those employing more than seven were private enterprises (*siying qiye*).[19] The 1982 Constitution then further stipulated that "the individual economy of urban and rural working people … [was] a supplement to the socialist public economy" (Article 11). More importantly, collectivisation was no longer a goal of government and the individual business development. The individual business sector was deemed a long-term economic sector.

The thrust of policies during the early 1980s mainly aimed at solving unemployment problems, especially among the "returned youth" who had been sent to rural areas during the Cultural Revolution as well as filling the economic gaps left by the state sector. From 1978 to 1982, 1,471,000 jobless people were absorbed into the individual business.[20] Cadres and state employees were not qualified to embark upon individual businesses. The phrase "supplement to the socialist public economy" implied no significant role for the private sector in economic modernisation. However, the policy imposed no real regulations upon the private sector.

Private businesses in certain areas went beyond the limit of "seven employees" from their inception. Facing the spontaneous growth of the private sector, the Party

[18] *Geti siying jingji zhengce fagui xuanbian* [Selected Laws and Regulations on Individual and Private Economies] (Beijing: Qiye guanli chubanshe, 1996), 62-5.

[19] According to another source, quoted from the work of Karl Marx that reads that those businesspeople employing more than seven persons became capitalists, the line of demarcation between *getihu* and private enterprise was drawn accordingly. See X. L. Ding, "The Disparity between Idealistic and Instrumental Chinese Reformers," *Asian Survey* 28, 11 (November, 1988): 1129-30.

[20] Feng Chen, *Economic Transition and Political Legitimacy in Post-Mao China: Ideology and Reform* (New York: State University of New York Press, 1995), 130.

adopted a wait-and-see approach. Not only did the private sector face uncertainty, so, too, did the Party. Nevertheless Party's leaders believed that the private sector remained too weak to challenge Party leadership. If any "negative" elements appeared, it would not be difficult to crack down on them. Hence, in 1983 the Party only responded with an indeterminate "three do-nots" policy to the emergence of private enterprises (*siying qiye*) — i.e. do not encourage them, do not publicly promote them, and do not ban them.[21] This ambivalent attitude gave much leeway to local officials to suppress "capitalist resurrections," and many businesspeople suffered setbacks during the early 1980s.

The Party passed a resolution on the economic reform at the Third Plenum of the CCP's Twelfth Central Committee in October 1984.[22] If the Third Plenum of the previous Central Committee was historically significant in "correcting the 'leftist' line of the Cultural Revolution," this later Third Plenum was significant in setting the goal for subsequent economic developments. To pursue a divergent path from the Soviet system, it was decided to build up "socialism with Chinese characteristics," in which, instead of fully depending upon planning, the Chinese socialist economy was to become a "planned commodity economy" in which the market, as a supplementary but indispensable force, was to remedy the shortcomings of mandatory planning. By the same token, instead of purely public ownership, diversified types of ownership were allowed, including not just individual businesses but also Sino-foreign joint ventures under the dominance of public ownership. The individual economy was recognised as having "an irreplaceable role in expanding production, meeting the people's daily needs

[21] Meng Jie & Jiang Shaomin, *Zaizao hunpo* [Remaking Soul] (Shenyang: Shenyang chubanshe, 1998).
[22] See the full text of the resolution from *Beijing Review* 27, 44 (October, 1984): III-XVI.

and providing employment. It is a necessary and valuable adjunct to the socialist economy and subordinate to it." And for the first time, the Party in the resolution allowed the leasing or contacting-out of small state-owned enterprises to collectives or individuals. This should be considered the first symptom of privatisation in post-Mao China.

After the six initial years of successful experiments with decentralisation reforms in rural areas, the Party felt confident enough to launch an all-around reform and try to separate government from urban SOEs (*zheng qi fenkai*). Despite the conservative Party leaders' complaints about "spiritual pollution" during the early 1980s, which was supposed to be caused by the resurrection of capitalist elements, the reformers in power believed that the private economy caused more benefit than harm.

To be sure, the policy towards the private economy still lagged behind the real situation of the private sector. The Party could not keep a wait-and-see attitude any longer, as the uncertainty had been engendering rows over whether capitalism was being regenerated in China. If it had been justifiable to allow individual businesses on the grounds that the owners of tiny concerns themselves were the labour who exploited nobody, how were the private enterprises which employed many wage labourers to be justified in socialist China? At the Party Thirteenth National Congress in October 1987, the Party formally endorsed the existence of private enterprises. Based on the resolution adopted by the 1984 Third Plenum, the Party theorised that China remained in the "primary stage of socialism."[23] At that stage, the principal contradiction lay in between the growing material and cultural needs of the people and backward production. Based

[23] See the full text of the Zhao's report from *Beijing Review* 30, 45 (9-15 November 1987): I-XXVII.

on the premise, the private sector should be allowed as "practice proved that a certain degree of development of the private sector promoted production." The toleration of it implicitly subscribed to and re-employed the notion "merit of exploitation" put forward by Liu Shaoqi in Tianjin in 1949.[24] At the Plenum, Zhao Ziyang, who just assumed the position of Party General Secretary, justified the existence of the private sector on the grounds that it would not threat socialism in China — because "the private sector is bound up with the public sector, which remains predominant."[25]

In spite of the Party's endorsement, the uncertainty about the Party line did not immediately fade away. The campaign against Bourgeois Liberalisation had just been launched, leading to the purge of Hu Yaobang. The justification for the existence of the private sector was not particularly sound from the perspective of orthodox Marxism, and the Party did not deny the problem of "exploitation" caused by the private economy. If the private sector was growing at the expense of the public sector, would the public sector remain dominant in the national economy, and thus was the toleration justifiable?

To be sure, in terms of the overall national economy, the private economy remained very weak. It only constituted 3% of the gross national industrial output in 1987.[26] But in some regions, the private economy had already taken on a significant role. For example, in Wenzhou Prefecture in Zhejiang Province, a significant cradle of the private economy in the post-Mao era, the private sector accounted for 34.4% of the

[24] The notion was drawn from his speech to the cadres in Tianjin delivered right after the liberation. By the speech, Liu intended to correct the "leftist" practice of the cadres who suppressed the private business in Tianjin. Liu exhorted them not to impose radical measures upon the private business and suggested that the exploitation of capitalism was not a sin at that time but made contribution. See the text from *Dang de wenxian* [Document of the Party], 5 (1993): 4-9.
[25] *Beijing Review* 30, 45 (9-15 November 1987): XIV.
[26] *China Statistical Yearbook 1989* (New York: Praeger, 1990), 224.

gross industrial output in 1986. That did not include the contribution of private enterprises that were registered as collectives.[27]

A Mixed Interim (1988-1991)

The years from 1988 to 1991 experienced the most politically and economically unstable time in the Deng era. From the mid-1980s, the Party switched to tackling the crux of the reforms — urban economic reforms — but that proved to be more difficult and complicated than the rural reforms and ultimately induced a political crisis at the close of the 1980s. In this period, the private enterprise was for the first time after the socialist transformation legalised in 1987. And in 1988 a provision was added to Article 11 of the constitution:

> "The state permits the private economy to exist and to develop within the limits prescribed by law. The private economy is a supplement to the socialist public economy. The state protects the lawful rights and interests of the private economy and provides guidance, supervision and control."[28]

On 25 June 1988, the State Council promulgated "Provisional Regulations on Private Enterprises."[29] This was the first set of comprehensive regulations on private enterprises since the Party proclaimed that China had entered the socialist stage. It defined all private economic organisations that had eight or more employees as belonging to the category of a "private enterprise" (*siying qiye*). Cadres and state employees were allowed to open their own enterprises after resigning from their posts.

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[27] *Zhongguo de siying jingji — xianzhuang, wenti, qianjing* [Chinese Private Economy: Current Situation, Problems and Prospect] (Beijing: Shehui kexue chubanshe, 1989), 137.
[28] Quoted from Jianfu Chen, "The Revision of the Constitution in the PRC," *China Perspectives*, 24 (July-August, 1999): 78.
[29] See the Regulations from *Beijing Review* 32, 10 (6-12 March 1989): IX-XIV.

The private enterprises were divided into three types: wholly individually-owned enterprises, partnership enterprises and limited liability companies. Wholly individually-owned enterprises (*duzi qiye*) referred to enterprises invested in and operated by one person who bore unlimited liability for the enterprise's debts. Partnership enterprises (*hehuo qiye*) referred to enterprises jointly invested in and operated by two or more persons in accordance with an agreement concluded by them. The enterprises also bore unlimited liability. Limited liability companies referred to enterprises invested in by at least two but generally not more than 30 persons who bore liability according to the amount of their investment. These enterprises needed to carry the word "limited liability company" (*youxian zeren gongsi*) or "limited company" (*youxian gongsi*) in the concerns' name. In addition, the "company" possessed a separate "legal person" status.

It should be explained that in China, the term company (*gongsi*) with regard to the private economy only refers to a limited company with a legal person status. Other types of private enterprises cannot carry the word "company" — *gongsi* — in their name and usually possess no legal person status, though collective and state enterprises can be named "*gongsi*," and possibly possess no legal person status. In many other countries, unlimited companies with legal person status are allowed legally, and one-man owned enterprises can be called a "company" and registered as a limited company.

Although the status of private enterprises was legalised, their operations were circumscribed by the Regulations. According to the Provisional Regulations, for example, the salary of a director or manager had to be limited to less than 10 times the average salary of the workers. No less than 50% of the after-tax profit had to be reinvested in the enterprise; otherwise, permission needed to be sought from the tax authorities. In addition, the private sector was still prohibited from engaging in financial, railway, munitions and many other industries that were monopolised by state enterprises.

The promulgation of the new regulations did not spur any great enthusiasm to re-register enterprises. It was officially estimated that there should have been 225,000 enterprises eligible to be private enterprises in 1988, including respectively 50,000 and 60,000 units that were registered as collective and co-operative firms. But about 40,000 firms were registered as private enterprises by the end of 1988.[30] Private entrepreneurs seemed to be taking a wait-and-see attitude. Even though the private economy was recognised as a positive contributor to the overall economic development in China, private entrepreneurs were at the same time deemed "capitalists" (*zibenjia*) in the sense that they were exploiting workers under the definition laid down by Karl Marx. The political instability of 1988-9 further discouraged them from taking a bold step.

After the Tiananmen protests of 1989 were crushed, the "evil" capitalist nature of the private economy was canvassed and castigated. In the Party Central Document No. 9 issued in August 1989, the relationship between private enterprise owners and their employees was formally defined as one of exploiters and exploited.[31] Private businesspeople were denounced for evading taxes, for competing with state enterprises for scarce resources, for disturbing the state's central planning, and for injuring the interests of the state and the people simply for profit's sake. These accusations seemed

[30] See *Beijing Review* 32, 3 (16-22 January 1989): 30-1 & Zhu Fangmin et al., *Siyou jingji zai Zhongguo* [Privately-owned Economy in China] (Beijing: Zhongguo chengshi chubanshe, 1998), 78.

[31] Li Zhenjie, *Siying qiye taoshi* [Perspective on Private Enterprises] (Beijing: Jingji guanli chubanshe, 1999), 40.

to take businesspeople back to the nightmare of the 1952 Five-Anti Campaign. The Party conservatives instigated waves of propaganda against Bourgeois Liberalisation from 1990 to 1991 in which they reached a conclusion that the private economy was the economic root of Bourgeois Liberalisation and the development of it was leading to the privatisation of the national economy.[32]

Meanwhile, a policy of "economic rectification" was adopted at the Fifth Plenum of the Thirteenth Party Central Committee in November 1989. The "rectification" was aimed to control inflation and restore economic order over the next three years. Despite claiming that the government was persisting in the line of "reform," the concrete policies adopted by the then premier Li Peng retreated from the Thirteenth National Party Congress by carrying out economic austerity. The domino effect of the collapse of the Eastern European Communist Bloc since 1990 further spurred the Party to take a defensive strategy lest China might "peacefully evolve" (*heping yanbian*) into capitalism. The conservative faction queried in various mass media the political nature of various reform measures — as to whether they were surnamed "socialism" or "capitalism."

Alongside this political adversity, various heavy fees were levied on private businesses. Some of the firms were thus forced to close down. As a result, the number of small individual businesses decreased by 14% in 1989.[33] And private enterprises were sharply reduced by about 14,000 right after the June 4 Incident.[34] Wenzhou, long

[32] Ma Licheng & Ling Zhijun, *Jiaofeng* [Crossing Swords] (Beijing: Jinri chubanshe, 1998), 93.
[33] Zhang Houyi & Ming Zhili (eds.), *Zhongguo siying qiye fazhan baogao* (1987-1998) [Report on the Development of China Private Economies (1987-1998)] (Beijing: Shehui kexue wenxian chubanshe, 1999), 93.
[34] *Zhongguo gongshang* [China Industry and Commerce], 125 (May, 1996): 13.

regarded as the "hotbed" of capitalism in China, could not avoid attacks. In response to various "disclosures" of Wenzhou's capitalist development, the State Council dispatched four investigation teams to Wenzhou between 1989 and 1991 to look into whether Wenzhou was fostering capitalism. Fortunately, Qiao Shi and Li Ruihuan, known as leaders of the liberal faction, respectively paid visits to Wenzhou and endorsed its contribution to Chinese economic development.[35]

Although radical measures were imposed upon private businesses locally, the central policy towards the private economy was not basically revised. While Deng was upholding "combat against Bourgeoisie Liberalisation," he tried to confine it to non-economic aspects. One of the then largest private enterprises (registered as a collective enterprise), Stone Group, was implicated in the sponsorship of the students' protest and the president of the company, Wan Runnan, fled to France after the government crackdown, but the corporation kept operating after a government-led reshuffle and today remains one of the biggest private business groups.[36] Right after the Tiananmen crackdown, Deng reiterated that the policy line adopted by the Thirteenth National Party Congress would not be altered, remarking: "Whoever alters it must step down."[37] After the political turmoil, Deng firmly believed that political stability could only be guaranteed by efficacious economic reforms. The existence of the private economy was part of this. The Party also intended to distract the popular attention from political issues by channelling energy into business.

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[35] Ling Zhijun, *Chen Fu* [Sinking and Floating] (Shanghai: Dongfang chuban zhongxin, 1998),151-7.

[36] For the history of the Group, see Scott Kennedy, "The Stone Group: State Client or Market Pathbreaker?" *The China Quarterly*, 152 (December, 1997): 746-777.

[37] *Deng Xiaoping wenxuan* [Selected Works of Deng Xiaoping], vol. 3 (Tianjin: Tianjin renmin chubanshe, 1993), 324.

The first decade of the reforms resembled the economic situation of the first years of the PRC in the sense that there existed a dual-track system: co-existence of planning and the market. Although the market was to play a "supplementary role" in policy, like Chen Yun portrayed the system as a "birdcage" economy in which the bird (the market) could not flee from the cage (plan). But the fact was that the market was shaking the foundation of the planning system. This was in part reflected by speculative activities and rampant corruption, which spread throughout the 1980s and drew increasing attention from the conservative Party leaders, who held reservations about the market reforms and attributed the political and economic crises at that time to these reforms. However, whereas the Party had opted for nationalisation and abolition of the market in the 1950s, the Party leaders now could not take the old road again because it had not worked. If planning and the market were incompatible, it was imperative to pick one of them. They faced a Hobson's choice.

The Period of Active Promotion (1992-1997)

The standstill in economic reforms and the measures of austerity resulted in an economic recession. This concerned Deng, and in order to get the reforms moving forward again, in early 1992 Deng, at the age of 88, embarked upon a southern tour to the prosperous Pearl River Delta, including Shenzhen and Zhuhai, where there was a concentration of beneficiaries and supporters of the reforms.

During the southern tour, Deng called for the prolonged debate about the reforms to cease and urged bolder measures to implement the economic reforms. He declared that the criteria by which to judge whether the reforms were socialist consisted of whether they advanced the development of the productive forces, advanced the enhancement of the overall capacity of the country and advanced the improvement of people's living standards — the so-called "three advances" (*sange youliyu*). In short, any measures that helped to develop the economy were not antithetical to socialism. Deng was indicating that a planned economy was not synonymous with a socialist economy. Planning and market regulation could not be used to draw distinctions between socialism and capitalism. Both were only means of controlling economic activities that could be employed by both capitalist and socialist countries. Deng further urged people to take bolder steps to introduce the advanced business and management systems of capitalism.[38]

Deng's speeches during the southern tour were later adopted by the Fourteenth National Party Congress in October 1992 as the Party's policy guideline, by way of a report calling for the establishment of a "socialist market economy" in place of the "planned commodity economy." Although the report kept to the framework that the private sector was a supplement to the public sector, which includes enterprises owned by the state or collectives, it opened the door to "allow diverse sectors of the economy to develop side by side" and to encourage different sectors to jointly operate firms on a voluntary basis.[39] The importance to the private economy of the new policy did not lie in the concrete policy statements towards the private sector, but in the general policy line requiring the Party to embark on various attempts and experiments to establish the socialist market economy. Starting in 1992, various local governments issued their own regulations and policies to relax controls and to encourage the development of the

[38] See Deng's speeches in the southern tour from *Deng Xiaoping wenxuan*, op.cit., 370-383.
[39] See the full text of the report from *Beijing Review* 35, 43 (26 October – 1 November 1992): 9-32.

private sector, and local initiatives started to play a bigger role. For instance, as early as August 1992 the Jilin provincial government promulgated trial regulations to (1) allow the forming of consortia and joint ventures between private enterprises, collectives and SOEs, which could be formed in terms of limited companies or shareholding companies; (2) to allow contracting out, leasing out and selling off of SOEs to the private sector; and (3) to allow private enterprises with two or more investors and with more than 30,000 yuan of registered capital to possess a legal person status.[40] The first two measures were confirmed at the Third Plenum of the Party Central Committee in November 1993. The third measure went beyond the limits of the 1988 Provisional Regulations on Private Enterprises, which only allowed limited companies to possess a legal person status. The years from 1992 to 1994 experienced a take-off in the growth of private enterprises. In 1994, it reached an annual growth rate of 81.7% (See Table 3.1).

The Third Plenum of the Fourteenth Party Central Committee put forward a plan to crystallise the establishment of the socialist market economy. The policy was based upon a new notion that the market was to play the fundamental role in resource allocation, with only macroeconomic controls by the state. The property rights of the enterprises were clearly defined by means of establishing a "modern enterprise system" in which the ownership and the rights of the enterprise were to be separated by turning the enterprise into an independent legal entity. And ownership of the enterprise would become scattered. This was a new attempt to separate government from enterprises.[41]

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[40] *Geti siying jingji zhengce fagui xuanbian*, op.cit., 602-3.

[41] The idea of establishing "modern enterprise system" was inspired by the development of business enterprises in the United States and was influenced by the work of Alfred D. Chandler: *The Visible Hand: The Managerial Revolution in American Business* (Cambridge: Harvard University Press, 1977). I am indebted to Edward Xin Gu for this point.

Although the reform aimed primarily at restructuring the state sector, this structural reform had a profound impact upon the entire economic system. First of all, the property rights reform was for the first time set as a major goal, though it had been experimented with since the late 1980s. The clarity of property rights was important not only to the state sector but also to all other sectors. This marked the beginning of the state's show of official respect towards private property. Second, to establish a market economy meant the abolition of a dual-track economic system, which helped to put the different sectors on an equal footing. Third, establishing a "modern enterprise system" implied that the enterprises, as independent legal entities, were not to be classified according to types of ownership but rather means of investment and responsibility. The sources of investment could become more diversified, which helped the entrance of the private sector into different industries and sectors. The concept of "legal entity" was applied to economic organisations from the late 1980s and private limited companies were granted a legal person status as noted above. However, this had not been put in full play until this reform. Last but not least, under the modern enterprise system, entrepreneurs in the sense of risk-takers and innovators, instead of economic bureaucracies or factory directors (*changzhang*), assumed the management of enterprises. Entrepreneurs (*qiyejia*), as "economically competent" (*jingji nengren*), were considered a key to the generation of wealth for enterprises.

This shift was very important to the legitimacy of private businesspeople. On the one hand, the entrepreneurs, no matter whether associated with state or private enterprises, started to be regarded as a resource to promote the welfare of the country. And private businesspeople were no longer simply considered "capitalists" but entrepreneurs. On the other hand, in order to transform those managers/entrepreneurs of SOEs into risk-takers and innovators, they started to be formally granted residual claims to the SOEs, including in the form of stocks. This was fostered another source of private entrepreneurs (I will further elaborate on this point in the next chapter).

In accordance with the new policy line, various reforms were launched from 1994 onward, including a tax reform and unification of currency exchange rates. The implementation of the Company Law as of July 1994 was very significant, in that its promulgation marked a key attempt by the Party to establish a corporate law regime in line with international standards. The primary aim of the law was to address the need for establishing the "modern company system," especially for the ailing SOEs. The Party also wanted to facilitate various forms of inter-sectoral business co-operations that included participation of the private sector.[42] Hence, unlike the preceding adopted laws governing economic entities, the theme of the law does not cover one specific type of ownership or source of investment in enterprises. It is applicable to almost all types of ownership, including state-owned, township-village, private, and foreign-funded enterprises, provided that they fulfil the conditions stipulated by the law which only governs two types of legal entities — limited company and shareholding company (*gufen youxian gongsi*). Of these two types, the limited company is more relevant to the growth of the private economy at the current stage.

The conditions for establishing limited companies in accordance with both the Provisional Regulations on Private Enterprises (hereafter, the Regulations) and the law

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[42] "Interpretation of PRC Company Law (draft)"(15 February 1993) from Wang Baoshu & Cui Qinzhi, *Zhongguo gongshifa yuanli* [Principles of China's Company Law] (Beijing: Shehui kexue wanxian chubanshe, 1998), 420.

are similar. Both require at least two shareholders in a limited company. But the shareholders under the Regulations only refer to natural persons, while they can be either natural or legal persons under the law. SOEs and foreign-funded enterprises are granted preferential treatment by allowing their limited companies to be invested in by one legal entity and one natural person respectively. Different from the Regulations, the law stipulates no minimum number of employees for forming a company. Hence, from the jurisprudential point of view, business firms employing less than eight persons could be registered as a private company.[43]

However, the law stipulates a minimum amount of registered capital for establishing a limited company. Although the Regulations did not, there were corresponding regulations issued in 1988 stipulating the minimum registered capital for "legal person" enterprises, and this also applied to the registration of private limited companies.[44] The conditions required by the law and the Regulations are almost the same. Both stipulate that the minimum registered capital for establishing limited companies ranges from 100,000 to 500,000 yuan, depending upon which industry a company embarks upon. But the law requires that companies in manufacturing have to have at least 500,000 yuan of capital, whereas only 300,000 yuan is required by the regulations. For other industries, both stipulate the same requirements. The stipulations regarding minimum registered capital and a minimum shareholders compare to those for establishing public companies under the English Company Law, which similarly

[43] To my knowledge, the state administration in many places, like Beijing, has allowed private limited companies that employ less than 8 persons since the promulgation of the Company Law.

[44] See "Implementation Codes for Regulations on Legal-Person Enterprise Management (1988)" from Gao Qiao (ed.), *Zuixin qiye jingying falü fagui shiwu zhinan* [Directory of New Laws and Regulations on Enterprise Operation] (Beijing: Qiye guanli chubanshe, 1994), 153.

requires at least two members to form a public company and £50,000 as minimum capital, whereas private companies may have one member with £1 as capital.[45] Of course, the limited companies in China are not public companies in the sense that they cannot issue stock, while only shareholding companies can do so. Obviously, the Chinese Company Law was enacted not to boost sole proprietorships, while larger private companies formed by share capital and partnership, like public companies in other market economies, were allowed. In this sense, private companies should not thrive in the subsequent years, but a surprise ensued.

In 1992 and 1993, the annual growth rate of private limited companies was remarkable — 164.7% and 274.9% respectively (See Table 3.1). While the years between 1992 and 1994 (before the promulgation of the Company Law) experienced the highest growth rate, it only marked a take-off. In terms of absolute value as an indicator, the figures look quite different. The annual additional number of all types of private enterprises and limited companies reached a peak in 1995 (after the promulgation of the Company Law) — respectively 232,090 and 109,478. While the overall growth trend plunged between 1996 and 1997, the limited companies sustained the momentum and rose again from 1997, chalking up another peak in 1998 (See Figure 3.2). The growth of private enterprises was mainly led by both wholly individually-owned enterprises and limited companies before 1995. It was the latter which accounted for the majority of the growth after 1995 (See Figure 3.2).

[45] Stephen W. Mayson, Derek French & Christopher L. Ryan, *Company Law* (London: Blackstone Press, 1993), 34.

Table 3.1: Official Statistics on the Growth of Private Enterprises (1989-1998)

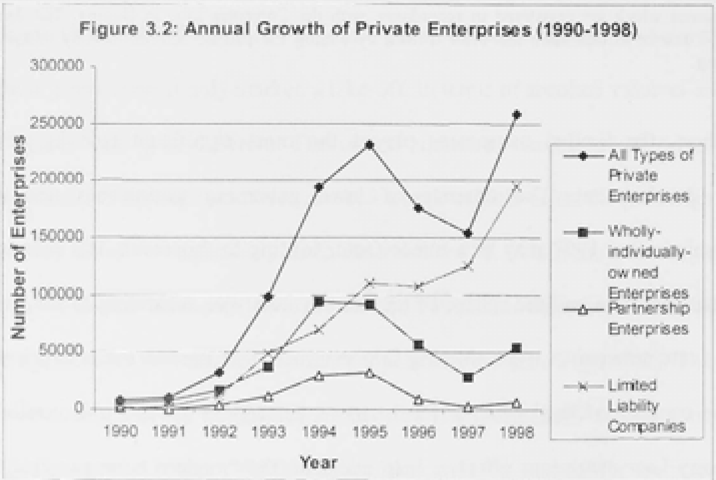
Year	Total No. of Private Enterprises	Growth Rate (%)	No. of Wholly Individually-owned Enterprises and Share	Growth Rate (%)	No. of Partnership Enterprises and Share	Growth Rate (%)	No. of Limited Liability Companies and Share	Growth Rate (%)
1989	90581		48172(53%)		38573(43%)		3836(4%)	
1990	98141	8.4%	53491(55%)	11.0%	40303(41%)	4.5%	4347(4%)	13.3%
1991	107843	9.9%	60613(56%)	13.3%	40552(38%)	0.6%	6678(6%)	53.6%
1992	139633	29.5%	77268(55%)	27.5%	44692(32%)	10.2%	17673(13%)	164.7%
1993	237919	70.4%	114944(48%)	48.8%	56722(24%)	26.9%	66253(28%)	274.9%
1994	432240	81.7%	209852(49%)	82.6%	86594(20%)	52.7%	135794(31%)	105.0%
1995	664330*	53.7%	301153(45%)	43.5%	118354(18%)	36.7%	245272(37%)*	80.6%
1996	840612*	25.5%	358453(43%)	19.0%	127763(15%)	8.0%	353242(42%)*	44.0%
1997	994647*	18.3%	387534(39%)	8.1%	130668(13%)	2.3%	478396(48%)*	35.4%
1998	1252659*	25.9%	441734(35%)	14.0%	137661(11%)	5.4%	673682(54%)*	40.8%
Average Rate of Growth		36.0%		29.8%		16.4%		90.3%

Sources: *Zhongguo gongshang tongji ziliao* [Statistical Materials of China Industry and Commerce] (State Administration of Industry and Commerce, 1989-1) & *Zhongguo gongshang xingzheng guanli nianjian* [Yearbook of the Industrial and Commercial Administration of China] (Beijing: Gongshang chubanshe, 1993-9). * The original aggregate national data do not contain the private limited liability companies which are registered in accordance with the Company Law in Beijing. The data from 1995-8 shown in this table has been revised by adding the private limited liability companies in Beijing.

In short, the limited companies played the most significant role in private economic development. The absence of laws governing partnership and sole proprietorship before 1997 may be a minor factor leading to this result. But it is more relevant that the scale and the sphere of private business was expanding to the extent that the private enterprises were entering into contracts that needed the enterprises to possess the capacity of legal persons. Furthermore, as early as 1992, a trial version of the Company Law came into effect to help establish the "modern company system." Any enterprises registered as limited companies and shareholding companies started to be regulated by corresponding administrative rules issued by the State Commission on Economic System Reform that had already provided a prototype,[46] while the

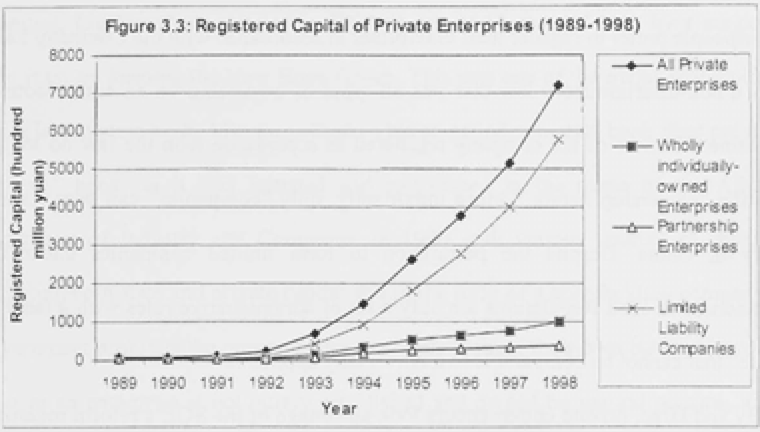
[46] See State Commission on Economic System Reform Document (1992) no. 31.

promulgation of the Company Law in 1993 further emboldened the growth of the private limited companies. In 1994, there were 135,794 private limited companies, while there were 245,272 in 1995, a net increase of over 100,000. In 1995, 134,723 were registered in accordance with the newly adopted Company Law.[47] Of these companies, if all of the newly registered limited companies were supposed to be subject to the regulation of the Company Law, most of the rest, about 25,000 firms, were undoubtedly the old limited companies that switched to the new system. The share of the limited companies subject to the new system increased from 52.5% in 1995 to 81.7% in 1997.[48]



Sources: compiled from Table 3.1.

[47] *Zhongguo gongshang xingzheng guanli nianjian* (1996), op. cit., 146, 416.
[48] Ibid. (1998), 454.



Sources: *Zhongguo gongshang tongji ziliao* (1989-1), op. cit. & *Zhongguo gongshang xingzheng guanli nianjian* (1993-9), op. cit.

In terms of registered capital, the figure is more astonishing. In 1993, the registered capital of limited companies had already constituted 64.06% of the total registered capital of all private enterprises.[49] In 1998, this rose to 80.41% of the capital (See Figure 3.3).[50] To be sure, the figure concerning registered capital should be qualified. Different from many other countries such as Britain, which set no minimum capital requirement for setting up limited companies, China's Company law stipulates a minimum level of registered capital, an amount that is very high in terms of the income level of the populace. Hence, the more limited companies that are established, the more the amount of registered capital of the limited companies overshadows two other types of enterprises — wholly individually-owned and partnership enterprises. In fact, the owners of limited companies may not really have sufficient initial capital. They often

[49] Ibid. (1994), Chapter 7: 25.
[50] Ibid. (1999), 432-3.

overstate the capital during the initial registration.[51] This reflects the fact that private businesspeople prefer to register their enterprises in accordance with the Company Law, as it is a non-discriminatory law that sets all types of ownership on an equal footing. The business licence of the company registered in accordance with the law no longer shows the "ownership nature." More importantly, only "companies" can bear limited liability in China. Despite the permission to form limited companies under the Regulations, the 1988 Regulations are only a set of administrative rules with a label of "private" that cannot be comparable to a universally applied law.

By and large, private entrepreneurs took advantage of the SOE's reform measures to seek a new niche and utilised it better than the state sector. In Beijing, for instance, among 63,606 limited companies in Beijing in 1998, 59,690 (94%) were privately owned. The ratio of incorporation of private enterprises is much higher than that of SOEs.[52]

Besides the unintended proliferation of private companies, other SOE reform measures indirectly boosted the private economy. The encouragement of developing public-private consortia or joint ventures, the permission to sell small SOEs, the shareholding system reform (*gufenhua gaige*) and the establishment of stock markets were measures aimed primarily to save ailing SOEs. But the consequence was to encourage the development of the private sector in the form of privatisation. A typical example is the biggest private conglomerate, Hope Group. Since 1992, this Sichuan-based conglomerate has formed joint ventures with or bought off over thirty SOEs in

[51] Further elaboration on this observation will be seen in Chapter 5.
[52] *Zhongguo gongshang xingzheng guanli nianjian* (1999) op. cit., 147-8.

various provinces in the name of participating in the SOE reform.[53] In 1996, one of its founders, Liu Yonghao, selected in 2000 as one of 50 stars of Asia by a magazine,[54] split it up by forming the New Hope Group. This was one of the major shareholders of the sole non-state bank, Minsheng Bank. This so-called non-state bank does not mean a "private" bank, as it was initiated and established in the name of the All China Federation of Industry and Commerce in 1996 with various sources of investment including both state and private capital and in the form of a shareholding company. The government prohibits the private sector from establishing their own banks. However, as long as an enterprise is not purely established and owned by natural persons, it is not officially regarded as a "private" enterprise. Interestingly, the New Hope Group as well as another private conglomerate, Orient Group, is now holding majority shares in the bank by purchasing the shares held by other private and state legal entities.[55] The shareholding system reform along with the establishment of stock markets in Shanghai and Shenzhen underscored the "implicit" legitimatisation of privatisation. Even though it was supposed that the state should have held the majority of the shares of most listed SOEs, which were prohibited from selling off state and corporate shares, many of these shares were sold off without regard to the rule from the very beginning.[56]

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[53] *Shichangbao* [Market Daily], 13 March 1999: 5.

[54] "The Stars of Asia: 50 Leaders at the Forefront of Change," *Business Week* (Asian edition), 3 July 2000: 36A2-3.

[55] *Zhonghua gongshang shibao* [China Business Times], 14 March 2000 (Internet edition: www.cbt.com.cn).

[56] See Shu-yun Ma, "Shareholding System Reform: The Chinese Way of Privatization," *Communist Economies & Economic Transformation* 7, 2 (1995): 159-174. It is reported that the Chinese government is planning to sell off the state share in order to fund the social security system. See *Business Weekly*, 18 June 2000: 4.

The New Hope Group is not an isolated case. In Hunan Province, for instance, 1,463 SOEs had been taken over by private enterprises by the end of 1997.[57] In some localities like Shunde in Guangdong Province and Chucheng in Shandong Province, the local governments launched a large-scale privatisation programme by selling off their SOEs to the private sector or by shareholding reforms, including restructuring enterprises into employee-owned firms.

To be sure, the development of the private economy had been solidly guaranteed by state policy since 1992, but the corresponding institutional and legal frameworks remained at the starting point. The infringement of private property remained common due to the legacy of indeterminate property rights of old private enterprises and the lack of other legal reforms that ought to have been adjusted to suit an economy with diversified types of ownership. The private sector's access to resources was still restricted by the old institutions. For instance, most private enterprises still found it difficult to have access to bank loans, which were almost monopolised by the state banks and were mostly allocated to the SOEs. The private enterprises still enjoyed no independent rights to export and import and thus had to attach themselves to the state foreign trade enterprises.[58]

On the other hand, the integration of private and state capital since the early 1990s started blurring the boundary between the state sector and the private sector. The trend of privatisation again engendered a crisis of legitimacy of the reforms, which continued

[57] *Zhonghua gongshang shibao* [China Business Times], 3 April 1999: 3.
[58] But the Special Economic Zones started granting the rights of export and import to individual private enterprises under their jurisdiction.

to stress the dominant status of the public sector in a socialist market economy. The Fifteenth National Party Congress in September 1997 tackled this issue.

The Convergence of Public and Private (1997 to the Present)

The year 1997 was a significant watershed. Deng Xiaoping, the helmsman of the post-Mao reform, passed away in February. The sovereignty of Hong Kong reverted to China in July. Two months later, the Party held its Fifteenth National Congress. Soon after, the East Asian financial crisis erupted. These latter two issues had a profound impact upon the private economy's development. The 1997 Party Congress further enhanced the status of the private economy, while the East Asian financial crisis demonstrated to the Chinese government that the state's protection of the SOEs might lead to disastrous consequences. As a result, not only the boundary between the public and the private sector but also that in economic policymaking started to be blurred.

After the southern tour of Deng, as noted above, the private economy has boomed to the extent that it is not simply a supplement to the public economy. The shareholding reform revitalised the local economies in experiments in Shunde, Chucheng and elsewhere. However, this engendered debates over whether the shareholding system should be considered "public" or "private." After the death of Deng, Deng's line was deemed irreversible, and the Fifteenth Party Congress provided Jiang Zemin with a platform to give it his own "brand name." In his report to the Congress, Jiang pointed out that the public sector consisted of state-owned and collective enterprises, and the state-owned and collective stakes in the enterprises of mixed ownership. Jiang stressed that the forms of public ownership could be realised in diverse patterns. The shareholding system should be one of the patterns to realise public ownership as long as the state or collective bodies controlled a majority stake in the enterprises. Sticking to the previous line, Jiang kept to the frame that the state-owned economy should play the "leading" role of the national economy. However, it was not realised in terms of the share of the state sector in the national economy but in terms of the degree of state control. In this sense, only key sectors of the national economic backbone should be dominated by the state sector, whereas the overall economic share of the state sector might adequately decrease. It should be strengthened in terms of quality not quantity.[59]

Even though Jiang's argument for quality against quantity might make sense from the viewpoint of economics, the Party yielded to the *fait accompli* that the state retreated from the sphere it had previously controlled. The share of the state-owned economy had already plummeted since the beginning of the reforms. In 1980, the state sector accounted for 76% of gross industrial output; whereas this had been reduced to 31% in 1997.[60] Conversely, the non-public industrial sector, composed of indigenous and foreign private industries, rose from 0.48% in 1980 to 36% in 1997.[61] Hence, the Party Congress could not help but endorse the non-public economy as an "important component" of the socialist market economy. The new phrase — important component — was written into the constitution amended at the 1999 National People's Congress.

This endorsement hastened the private sector boom from 1997 onward, forming a second wave of growth (See Figure 3.2). In 1998, the number of registered private enterprises reached above 1,200,000 (See Table 3.1). In this second wave, the new

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[59] See the full text of the report from *Beijing Review* 40, 40 (6-12 October 1997): 10-33.
[60] *Zhongguo tongji nianjian* [China Statistical Yearbook 1999] (Beijing: Zhongguo tongji chubanshe, 1999), 423.
[61] Ibid.

private enterprises were composed of many enterprises that originally were registered as collective, whose owners were emboldened by the new line to re-register their enterprises as private enterprises in a so-called "taking off of red hats" (*zai hong maozi*), albeit a few cases had already occurred around the mid-1990s.

In 1995, the Party had confirmed the line of the SOEs' reform as "grasp the large, let the small go" (*zhuada fangxiao*). That meant the state only put resources into the 1,000 or so largest SOEs by reorganising them into conglomerates, like the *zaibatsu* or *chaebol* in Japan and South Korea. The debt-ridden and inefficient small-sized SOEs would be sold off, leased out or allowed to go bankrupt. The 1997 Party Congress kept to this line and determined to sort out the SOEs' difficulties within three years. The SOEs' reform from within has been among the least successful of the reforms, and the East Asian financial crisis gave China a lesson that if the Chinese SOEs' reform pointed in the direction of the Japanese and Korean model, a similar financial disaster might occur in China. The extraordinary concessions made to the United States in the negotiations on entry into the World Trade Organisation in 1999 marked the Chinese government's determination to expose the Chinese firms to markets rather than to protect them from the foreign competition.[62] The basic line of economic policy now implicitly but significantly deviates from what the Party claimed to defend: socialist public ownership. As Edward Steinfeld argues, "instead of using market forces to save state socialism, state socialism itself would have to be sacrificed to preserve the market

[62] The concessions included lifting the barrier on imported agricultural products, opening its lucrative telecommunications market and allowing American insurance companies sell policies throughout the country.

economy."[63] Although the state economic sector would not simply vanish, only those firms that adapted themselves to fierce competition would survive in future.

At sub-national levels, the private sector is now regarded as an indispensable force for boosting economic growth, whereas the exclusively state-owned enterprises are deemed economically inefficient. This notion is especially pronounced in the poor interior provinces whose governments attribute their slower pace of economic progress in part to the less developed private sector under their jurisdiction.[64] Hence, their economic plans now embrace the growth of the private economy. In Shaanxi Province, one of the interior provinces, for instance, the government required all county-level governments to stop establishing new SOEs and to switch to developing shareholding co-operatives and other types of non-public enterprises.[65] In Qingdao City in Shandong Province, the establishment of exclusively state-owned enterprises is now not easy to win approval. Only state enterprises with various sources of investment can obtain the city government's nod.[66]

The encouragement of mixed ownership leads to a blurring of the traditional boundary between public and private enterprises. The emergence of shareholding companies and shareholding co-operatives has the same effect even though this is regarded as a means to realise socialist public ownership. On the trend of developing mixed ownership, David Wank considers it a waning of the conscious distinction

[63] Edward S. Steinfeld, "Beyond the Transition: China's Economy at Century's End," *Current History* 98, 629 (September, 1999): 272.

[64] In 1998, the number of private enterprises and their investors and employees, and the amount of their registered capital in both western and central provinces only accounted for 35.5%, 39.4%, 37.8% and 49.3% of the national total figures. See Zhang Houyi & Ming Zhili (eds.), *Zhongguo siying qiye fazhan baogao* (1999) [Report on the Development of China Private Economies (1999)] (Beijing: Shehui kexue wenxian chubanshe, 2000), 45.

[65] *Zhonghua gongshang shibao* [China Business Times], 7 March 1997: 1.

[66] *Dagongbao* [Takungpao] (Hong Kong), 28 March 2000 (Internet edition: www.takungpao.com).

between legal public and private property rights.[67] It should be clarified that the mixed ownership does not necessarily induce a blurred property rights structure, as long as the distribution of company shares between the public and the private shareholders is clearly stipulated in accordance with the Company Law, like other types of partnership. Notably, the public-private joint ownership, as exists in China, is not unique in the world. The Commonwealth Bank and Qantas Airlines in Australia present two examples among many.

Needless to say, in China, this merging does not represent a re-nationalisation of private enterprises or bureaucratisation of economic organisations, which was the case in the 1950s.[68] Instead, the rhetorical legitimacy of socialism seems to be justified by the new ownership definition. Non-state and non-collective ownership is not necessarily identical to private ownership (*siren suoyouzhi*); and the shareholding transformation is not identical to privatisation in the sense of *siyouhua*. In Chinese, privatisation can be translated as either *minyinghua* or *siyouhua*. *Minyinghua* literally means that a state-run enterprise is transformed into an enterprise that is not operated by the state bureaucratic system. It can alternatively be understood as de-nationalisation. This is not taboo in the official discourse now. But *siyouhua* continues to be repudiated as a term. Although *minyinghua* is sometimes employed as a euphemism for *siyouhua*, the meaning of

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[67] David L. Wank, *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (Cambridge: Cambridge University Press, 1999), 207.

[68] X. L. Ding in his recent research substantiates that the public-private joint venture is significantly employed to drain away state assets. Here I agree that Ding's account is part of the story. See his "The Illicit Asset Stripping of Chinese State Firms," *The China Journal*, 43 (January, 2000): 1-28.

siyouhua is essentially different from that of *minyinghua*. *Siyou*, always translated as "privately-owned," should be understood as something owned by one person or family, or a couple of individuals. *Siyouhua* strictly refers to the takeover of a public enterprise by one or at almost a few natural persons.[69] When we discuss privatisation in socialist or former socialist countries, usually we refer not only to *siyouhua* but also to shareholding transformation and takeovers by private legal entities. However, the CCP discourse seems to refer only to the former now. And this type of privatisation is not the most prevalent in practice.

The enterprises formed by institutional investment and share capital, as a counterpart of public companies in other market-economy countries, are now put into the category of socialist public ownership, like Minsheng Bank noted above. These enterprises stem not only from collectives and SOEs but also from private enterprises, whose scale expands to become shareholding companies, which sometimes go public. In other words, some of the expanded private enterprises, which absorb multiple sources of investment, will fall into the category of socialist public ownership in the official discourse. Tian Jiyun, the Deputy Chairman of the National People's Congress (NPC), suggested in his address to the Second Plenum of the Ninth NPC in March 1999 that the development of the private economy would attain the stage where it takes the road of a

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[69] A senior Chinese economist, Yu Guangyuan, quoted from a work of Frederick Engels to clarify what private production is in Marxism. Engels said, "What is capitalist private production? Production by separate entrepreneurs, which is increasingly becoming an exception. Capitalist production by joint-stock companies is no longer private production but production on behalf of many associated people … this put an end not only to private production …" (here quoted from Karx Marx & Frederick Engels, *Karl Marx, Frederick Engels: Collected Works*, vol. 27 (London: Lawrence & Wishart, 1990), 224. Emphasis is original). In this sense, any production in association with the properties of more than one person is not "private" production. See his "Lishi shang he dangqian Zhongguo de siyou he gongyou" [Privately-owned and Publicly-owned in the Historical and the Current China], *Zhongguo siying jingji nianjian* [Yearbook of Chinese Private Economy] (1978-1993) (Hong Kong: Xianggang daobaoshe, 1994), 47.

shareholding transformation or shareholding co-operativisation; and this meets the needs of "socialised" (*shehuihua*) large-scale production.[70] In other words, any economic entity that contains "collaborative" elements can be defined as "socialistic."

In addition, economic policymaking is ever more industry-oriented rather than ownership-oriented. No matter the type of ownership, only enterprises in certain government-promoted industries can obtain preferential government treatment. In other fields, both the state and private enterprises would gradually be placed on an equal footing in policy treatment.[71] Furthermore, the scale of enterprises becomes a line of division in policymaking. Under the 1998 reform of China's administrative structure, a new Medium and Small-sized Enterprises Bureau was set up under the State Trade and Economic Commission to take charge of policies towards such enterprises, which include most of the private enterprises.

Two further sets of laws concerning the private enterprises were also adopted. These were the Partnership Enterprises Law and the Wholly Individually-owned Enterprises Law, which were adopted in 1997 and 1999 respectively. Along with the 1993 Company Law, thus, a complete set of laws concerning private enterprises has been built up. It should be noted that these laws were enacted not along the line of ownership but rather in terms of modes of investment and responsibility. This is an attempt not only to keep in line with international standards but also to de-emphasise the enterprise distinction by ownership.

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[70] *Liaowang* [Outlook], 791 (March, 1999): 4.

[71] For example, Shanghai in 1998 granted "national treatment" to the private sector. That means the government no longer discriminates against the private sector in economic policy, which can enjoy the same treatment as other sectors. See *Zhonghua gongshang shibao* [Chinese Business Times], 10 April 1998: 2.

It is premature to say that all private enterprises can now enjoy equal treatment with other sectors, because the close connections between the state sector and the government and the distortion and variations of policy implementation remain. However, the government increasingly relies upon the private sector for both economic development and revenue generation. What is more, the private enterprises have helped to absorb millions of laid-off workers from the SOEs. The decline of non-state investment in 1997 and 1998 aroused a great deal of concern by the state and, in response, independent rights to import and export goods were granted to the private sector in 1999 to stimulate private investment. Private enterprises are now deemed a means to bolster the foreign trade of China.[72]

In a word, current national economic policymaking erodes the distinction between public and private ownership, which is increasingly de-emphasised in the classification of enterprises.

Concluding Remarks

The development of policymaking towards the private economy has reflected a passive approach by the Party as it adopted a strategy of "crossing the river by groping for stones." Deng's pragmatism weakened state control over the development of the private sector. But this is not to argue that the extraordinary growth of the private sector was inevitable. The legacy of orthodox Marxism and Maoism has been a stumbling block to

[72] By the end of 1999, 438 private enterprises had been granted the right of import and export goods by the Ministry of Foreign Trade and Economic Co-operation. The total value of exports accomplished by the private sector was 130 million US dollars in that year. See *Zhonghua gongshang shibao* [Chinese Business Times], 17 February 2000 (Internet edition: www.cbt.com.cn).

such development. The setbacks suffered during the "mixed interim" period demonstrated the state's coercive power. On the other hand, whenever a step toward liberalisation was taken, it triggered a leap in growth. The key decision to replace planning with the market cleared up the uncertainty of the policy and accelerated the decline of the state sector. Minxin Pei's "societal takeover" has not taken account of the function of the market-facilitating state. Of course, the demonstration of the competitiveness of the private sector in economic development helped establish its legitimacy. That in turn pushed the government to guarantee the security of the property of private entrepreneurs and to adopt an accommodating approach to them. Now the "river-crossing" reformers are approaching the "opposite bank."

Still, state policymaking could not account well for the growth of the private sector. In particular, it could not make sense of how various resources of the private sector could derive from a state-dominated planning system. Moreover, the private economy grew in opposition to the state's initial goals for economic development. The scope of analysis needs to be enlarged beyond a focus on the top-down policy process. In the following chapter, I will reconstruct the trajectory of the development in a bottom-up approach, illustrated in terms of the urban private economy and IT industry.

Chapter 4: The Rise of the Urban Private Economy and of an Information Technology Industry

In Western political economy, the distinction between the public and private sectors and the implications for the polity and the economy are principal foci when examining mechanisms of allocation, the extent of redistribution and the ownership structures of a society.[1] By the same token, before his fieldwork studies David Wank presumed that the new private business community would generate its own resources and could be independent of the state apparatus. But he found that it was not empirically easy during his fieldwork to distinguish so clearly between public and private.[2] This situation led him to articulate his commercial clientelism thesis, in which the growth of private business was based upon dependent ties with the local government.

This cognition was to a certain extent misguided by his presumption that the private sector should not be intertwined with the state apparatus in an ideal typical model. This perception has two problems when applied to China. First, in socialist China, especially in the pre-reform and early years of the post-Mao era, state institutions were ubiquitous in the form of *danwei*, rural communes and many so-called social organisations which could be regarded as extensions of the state. How can one expect that a private sphere can suddenly and rapidly develop from scratch?

However, the "nominal" state institutions were not homogeneous. They contained informal aspects that were dysfunctional to the state. The growth of the

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[1] Jan-Erik Lane & Svante Ersson, *Comparative Political Economy: A Developmental Approach*, 2nd ed. (London: Pinterm, 1997), 109.

[2] David Wank, *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (Cambridge: Cambridge University Press, 1999), 3.

private economy reflected these aspects. While Wank perceives that the local state took advantage of its autonomy to exercise discretion in patronising the private sector, this phenomenon could also be perceived as private businesspeople taking advantage of local bureaucratic discretion to seek their own benefits and to siphon off resources from the state.

While Wank's perception is not groundless, it lacks a broader historical perspective that would enable us to delineate a chain of development. During the gradual transformation of the state-dominated economy, a certain degree of public-private conjunction was indispensable to the rapid growth of the private sector, as the public sector had manipulated key resources at the outset. Hence, the autonomy of the private sector was not significant at the outset, but has been strengthened alongside the development of a division of labour between the government and the business sector.[3] While China has not adopted a mass privatisation programme to achieve private ownership, a gradual transfer of public resources to private hands provided an alternative means. This transfer did not entail zero-sum redistribution. The private sector activated and added value to the state/public resources. A liberal Chinese economist, Fan Gang, has suggested that the economic reform in China worked along the lines of "incrementalism" in the sense that substantial development relied upon the growth of the non-state sectors, the institutions outside traditional state planning.[4] But I

[3] See Chen Chieh-hsüan's study of Mainland Chinese economic development in *Taiwan chanye de shehuixue yanjiu* [Studies of Taiwan's Industrial Sociology] (Taipei: Lianjing, 1998), 345-77.

[4] See Fan Gang, "Teshu de fangshi yu teshu de wenti — Zhongguo gaige de ruogan tezheng de lilun fenxi" [Special Approaches to Special Problems: A Theoretical Analysis of Some Characteristics in China's Reform], *Zhongguo yanjiu* [China Studies], 1 (Autumn, 1995): 37.

would like to add that these "exogenous" sectors were not isolated from the "old" institutions but made use of their resources.

The rise of the urban private economy, especially the private IT industry, can illustrate this point. This chapter examines the trajectory of private economic growth in urban China. It briefly reviews the growth of the urban private sector in the first section. The chapter then surveys the background to the growth of the information technology (IT) industry, which was to a large extent shaped by the urban private sector. Lastly we will examine private economic development in the two urban field sites of this study — Beijing and Guangzhou — where the private IT sector is thriving.

Origins and Development of the Urban Private Economy

An urban private sector began to emerge in the early 1980s, but it was far less developed than its rural counterpart throughout the decade. Most people with urban residency were assigned to work in *danwei* where they could obtain a basic security of livelihood. Yet a considerable number of urban inhabitants worked for poorly equipped urban collectives or engaged in self-employed business for a living.

After the turmoil of the Cultural Revolution (1966-68), a great many urban youths were sent down to the countryside and mountainous areas. From the early 1970s, they started to return to the cities without state approval. By the latter part of the 1970s, the local governments could not help but allow the returnees to engage in individual businesses (*getihu*) or set up urban collectives. Another major source of early private urban businesspeople was retired workers. Some of them might be skilled craftsmen in a particular trade like traditional arts and crafts. They maintained their skills and passed these on to younger workers, often their children.

The *getihu* businesspeople of the early 1980s mainly embarked upon repairs, carpentry, photography, eateries, catering, and transport — the economic gap left by the state sector. The urban private businesses concentrated upon the commercial and service sector while more rural private firms were in the industrial sector. Unlike their rural counterparts, the urban cadres during the first half of the 1980s were not engaged in private business due to state prohibitions, while cadres played more an entrepreneurial role in rural areas.[5] By the same token, the social status of urban *getihu* businesspeople was very low during the initial revival of private business. Only those who lacked a social network and could not find other employment were forced to do individual business. Most young people who were doing private business waited for opportunities to enter the state sector for a lifetime job. Cases were found by the mid-1980s of some state employees who quit their state jobs to go into business in order to rid themselves of humdrum routines or personnel disputes in the state sector,[6] but they were isolated cases.

The low self-esteem of *getihu* businesspeople changed starting from the mid-1980s. Their higher income made their career choice more desirable. State control over them was also loosening.[7] Despite their higher income, the businesspeople usually put most of their income into consumption, seldom into re-investment, because of their

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[5] Minxin Pei, *From Reform to Revolution: The Demise of Communism in China and the Soviet Union* (Cambridge: Harvard University Press, 1994), 110-1.

[6] See a case from *Beijing Review* 30, 49 (7-13 December 1987): 7.

[7] Thomas B. Gold, "China's Private Entrepreneurs: Small-scale Private Business Prospers under Socialism," *The China Business Review* 12, 6 (Nov.-Dec., 1985): 50.

distrust regarding the longevity of the "tolerant" policy.[8] Moreover, state policy did not encourage their expansion beyond the scope of an "individual" business; hence, there were no other outlets for their accumulated profits. Facing obstacles from the state institutions in cities, the urban private sector could not boom in parallel with the rural areas, where some local cadres disregarded central state policies. Accordingly, the rural private sector accounted for 90% of the gross private industrial output in 1987.[9] Nevertheless, the urban *getihu* did open a niche for the accumulation of private wealth and tempted people from other backgrounds into private business. By the end of 1985, 11,710,000 licensed *getihu* businesspeople possessed 16.4 billion yuan in funds, averaging 1,402 yuan per person.[10]

Privileged urban social groups started to go into business from the mid-1980s. They did not launch their businesses as *getihu*, but leased small SOEs or — pertinent to this study — started technology-based enterprises. As stated in the last chapter, since 1984 the state has leased or contracted out small state-owned firms to collectives, or to individuals who to a large extent came from the ranks of former state employees. By 1987, some 60% of all small state-owned firms had been leased out.[11] These firms were concentrated in the service sector, including retail outlets and food shops. Although the state ownership of these enterprises was kept intact, this fostered ranks of urban private entrepreneurs who were making use of state resources to earn seed capital and who later

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[8] Thomas B. Gold, "Guerrilla Interviewing among the *Getihu*," in Perry link, Richard Madsen & Paul G. Pickowicz (eds.), *Unofficial China: Popular Culture and Thought in the People's Republic* (Boulder: Westview Press, 1989), 186.

[9] *China Statistical Yearbook 1989* (New York: Praeger, 1990), 137.

[10] Feng Chen, *Economic Transition and Political Legitimacy in Post-Mao China. Ideology and Reform* (New York: State University of New York Press, 1995), 131.

[11] Willy Kraus, *Private Business in China: Revival between Ideology and Pragmatism* (Honolulu: University of Hawaii Press, 1991), 110.

launched their own businesses. Among my interviewees, two had the experience of running contracted-out state food shops in the 1980s.

To encourage modernisation of science and technology, universities, research institutes and individuals were allowed to establish profit-seeking research and technical service institutes from 1985. Many distinguished technology-based companies founded in the mid-1980s were initiated by scientific personnel from the state research institutes or universities, but these spin-off enterprises were usually registered as collectives or SOEs at that time and received a certain amount of state sponsorship. Some of these enterprises became private or semi-private firms by means of incorporation or shareholding transformation in the 1990s. These managers of public enterprises thus became private entrepreneurs.

The majority of the first generation of *getihu* businesspeople did not evolve into the backbone of the private economy in the later stages of development. According to two recent surveys conducted by a Chinese government agency and an academic institute, the current entrepreneurs of private enterprises mostly came from the ranks of cadres and professional technicians. The survey, conducted in Zhejiang, Henan and Gansu Provinces, by the State Council's System Reform Office, found that former cadres from state agencies and former professional technicians accounted for 54.7% of the entrepreneurs. Those that developed from *getihu* only constituted 18.6% of the sample.[12]

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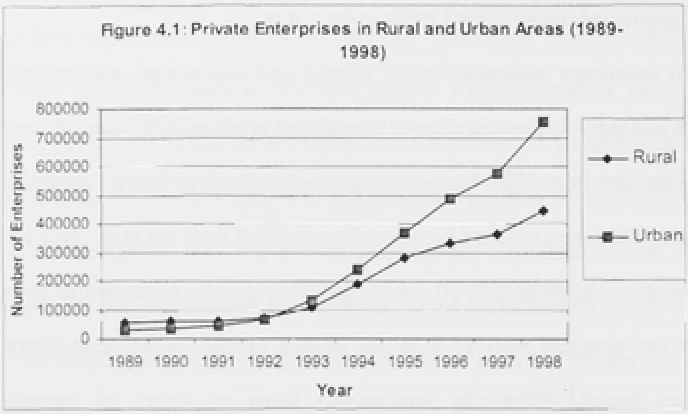
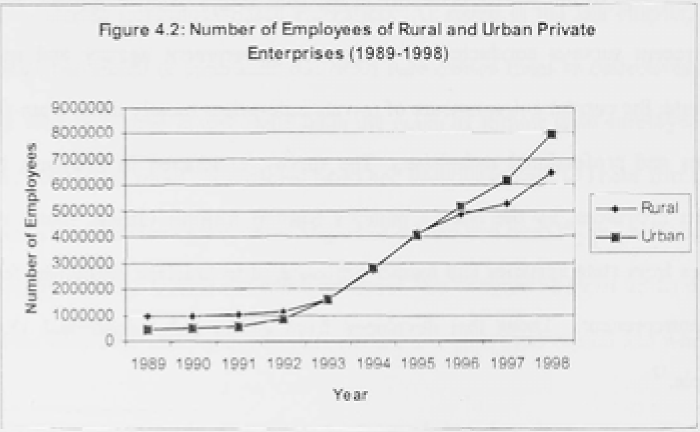
[12] For the survey done by Chinese Academy of Social Sciences. See *Dagongbao* [Takungpao] (Hong Kong), 2 February 1999 (Internet edition: www.takungpao.com). For the survey done by System Reform Office, see *Beijing kejibao* [Beijing Science and Technology News], 22 February 1999, quoted from *jingji zhengce xinxi* [Information on Economic Policies], 5 (1999): 26.



Sources: *Zhongguo gongshang tongji ziliao* [Statistical Materials of China Industry and Commerce] (State Administration of Industry and Commerce, 1989-1) & *Zhongguo gongshang xingzheng guanli nianjian* [Yearbook of the Industrial and Commercial Administration of China] (Beijing: Gongshang chubanshe, 1993-9).



Sources: The same as Figure 4.1

The urban private sector started to catch up with the rural sector from the early 1990s. The number of urban private enterprises overtook those in the rural sector in

1993 (See Figure 4.1), and by 1998, the number of urban private enterprises accounted for 62.9% of total private enterprises.[13] In 1994, the employees in urban private enterprises reached half of the total employees in all private enterprises and the urban employees constituted 55.1% in 1998 (See Figure 4.2).[14] The registered capital of urban private enterprise outstripped that of its rural counterpart as early as 1991. In 1998, the registered capital of urban enterprises almost tripled that of the rural sector, soaring to 533.4 billion yuan, while the latter only reached 186.2 billion yuan (See Figure 4.3).[15] In this regard, it should be qualified that the dominance of registered capital in urban private enterprises was due to the prevalence of limited companies among the urban private enterprises. As noted in the last chapter, it required a much higher minimum registered capital to set up a limited company in China. In 1990, the limited companies accounted for only 9% of urban private enterprises compared with 1.5% of rural private enterprises.[16] In 1994, the share of urban limited companies rose to 43%, while their rural counterparts only reached 17%.[17] The incorporation of urban "fake" collectives should account for a considerable proportion of them. By 1998, 366,000 urban collective enterprises with supervising units (*guakao danwei*) have been singled out nationwide to have their property rights clearly defined.[18] Incorporation is one of the means to clarify the property rights.

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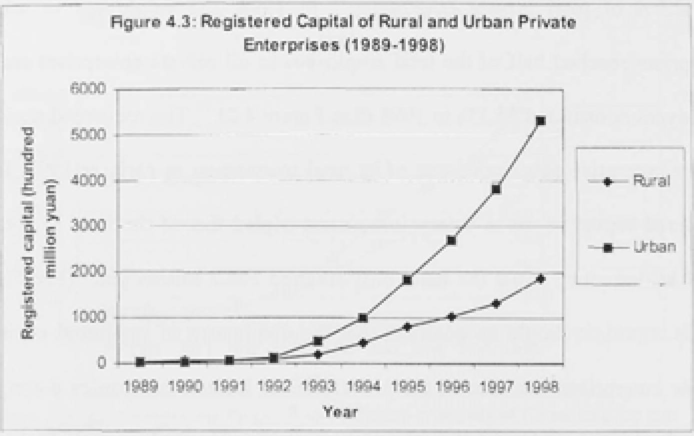
[13] *Zhongguo gongshang xingzheng guanli nianjian* [Yearbook of the Industrial and Commercial Administration of China] (Beijing: Gongshang chubanshe, 1999), 432.
[14] Ibid.
[15] Ibid (1992), 55 & (1999), 432.
[16] *Zhongguo gongshang tongji ziliao* [Statistical Materials of China Industry and Commerce] (State Administration of Industry and Commerce, 1991), 51.
[17] *Zhongguo gongshang xingzheng guanli nianjian* (1995), op. cit., 412-3.
[18] *Beijing jingjibao* [Beijing Economic Daily], 1 August 1999: 1.



Sources: The same as Figure 4.1

The upsurge of the urban private sector in the 1990s did not emerge from scratch. The reform of the state sector from the 1980s laid a significant foundation for the boom in the 1990s. Furthermore, it is significant to note that the growth of the urban private economy mainly occurred by unleashing state-controlled resources, especially human resources. State employees, especially cadres, have a better education, better personal networks, better access to information and a richer management experience than the vast majority of *getihu* businesspeople, leaving aside their better ability to corruptly siphon off state resources. Hence, they enjoyed an advantage in organising larger business firms. The scientific personnel and the advanced techniques they could apply gained the edge in market competition in the cutting-edge sectors. Forfeiting state jobs to go into business (*xiahai*) proliferated from the early 1990s, especially after Deng's southern tour. The gloomy career prospects of a state job vis-à-vis the growing business opportunities reduced the opportunity cost of forgoing the state job.

Background and Development of the IT Industry

Within the urban economy, the IT industry is a sunrise sector. As early as 1958, the first vacuum tube computer was produced in China, with the assistance of the Soviet Union, but the computer industry first arose not for commercial but for military purposes. After ties with the Soviet Union were severed, the development of computer technology became self-reliant from the mid-1960s to the 1970s. Although a partial shift from military to civilian applications occurred after the Cultural Revolution, the production was small in scale and the application was not for non-commercial purposes, mainly to aid scientific research and the management of various government agencies.[19]

With the advent of microcomputers in the 1980s, a commodification of the industry burgeoned at the same time. Taking advantage of China's opening up, the state sector started to import production lines from abroad with foreign currency quotas offered by the state to assemble computers domestically. However, this import-substitution strategy did not help to upgrade the local technological level. The imported technology was poor in handling Chinese fonts, and very little application software in Chinese was available. It is noteworthy that at that time the industry had not tapped the capability in computer technologies held by local research institutions.[20]

To integrate scientific research into industrialisation, the Party launched reform of the science and technology management system in 1985.[21] This was the Party's first

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[19] Otto W. Witzell & J. K. Lee Smith, *Closing the Gap: Computer Development in the People's Republic of China* (Boulder: Westview Press, 1989).

[20] Qiwen Lu, *China's Leap into the Information Age: Innovation and Organization in the Computer Industry* (New York: Oxford University Press, 2000), 9-10.

[21] See the policy from the "Party Centre's Decision on Reform of the Science and Technology Management System," *Xinhua yuebao* [New China Monthly], 485 (March, 1985): 104-8.

endeavour to link up scientific research with industrial production by creating a "technology market" and allowing research institutes and their personnel to set up profit-seeking organisations. From the mid-1980s onward, various spin-off enterprises, which were initiated by either individuals or institutions, burgeoned around the hubs of research institutes and institutes of higher education. These spin-offs were considered non-state enterprises in the sense that they received no state budgetary funding and operated in an independent manner, although they gained varying degrees of support from local authorities and many of them had even registered themselves as state-owned enterprises due to their status as subsidiaries of state research institutes or universities. To be sure, even though these parent institutes claim to have provided seed capital to set up the firms, the amount is usually small, and sometimes in the form of loans.[22]

Many of these spin-offs were computer businesses. In the 1980s, the four best-known spin-off enterprises, namely the Two Tongs and Two Hais — Sitong (i.e. Stone), Xintong, Kehai and Jinghai — all focused upon computer technology. Many of these spin-offs, generically called *minying* enterprises, now have been reorganised into private or semi-private enterprises by means of incorporation or a shareholding transformation.

The growth of the computer industry in the 1980s was mainly driven by the importation of foreign-made computers. The indigenous enterprises made use of the opening up to absorb foreign technologies and to accumulate capital by embarking upon sales of imported computers and components. For instance, the current top IT conglomerate, the Legend Group, a spin-off from the Institute of Computer Technology of the Chinese Academy of Sciences, started with sales and after-sales service of

[22] See such cases in Qiwen Lu, op. cit.

imported personal computers (PCs) in the 1980s. At that time, the users of computers were mainly composed of personnel in state agencies and research institutes. The marketplace remained very small.

It was not until the early 1990s that PCs started to be used within the urban populace. Despite the market dominance of the foreign brand names, like IBM, Compaq and AST, indigenous companies did not surrender the whole market to the foreign sector. The indigenous sector has been increasingly catching a larger market share through competitive pricing and by taking advantage of their familiarity with the domestic market. Starting at the end of the 1980s, many small private firms had already embarked upon producing IBM clones (without a brand name) by integrating imported components, known as "screwdriver assembly." Besides the larger indigenous computer companies, which put their brand-name PCs into the market, some domestic large-scale manufacturers of home electrical appliances, like Changhong, Haier and TCL, crammed themselves into this very competitive market at the end of the 1990s. After several years of competition, the two top PC vendors in the domestic market are no longer foreign but indigenous non-state brands: Legend and Founder (*Fangzheng*) a spin-off from Peking University.[23] It should be noted that the indigenous sector does not grow at the expense of the foreign sector. It rather is fostering the popularity of computers and thereafter helps the development of derivative businesses, including software and the Internet. Without the indigenous sector, it is hard to envision the upsurge of annual PC market sales from hundreds of thousands during the early 1990s to several millions now.

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[23] See *China Daily*, 1 December 1999 (Internet edition: www.chinadaily.com.cn).

To be sure, the "core" computer technologies are still dominated by foreign companies, mainly from the United States, Japan and Taiwan. Most computer chips, including the central processing unit (CPU) and the dynamic random access memory (DRAM), are not developed in China, though domestic firms are already starting to design and produce integrated circuit chips.[24] Chinese companies mainly participate in the later stages of the production chain and in the manufacturing of some peripheral accessories, like keyboards, power supplies and mice. This is partly a function of the international division of labour in which much of the local production is for foreign firms in accordance with the specifications designed by the foreign firms, and the products are abroad under the brand names of these foreign firms, i.e. original equipment manufacturing (OEM) arrangements. The production processes in China are mostly composed of labour-intensive assembly operations and are not technically demanding.[25] Despite this, this assembly work contributed to the remarkable growth of the computer industry in China. While the output value of the computer industry was only 5.2 billion yuan in 1991, it increased by 16.5 times, reaching 86 billion yuan, in 1998.[26] In 1999, China was the fifth biggest hardware exporter and is forecast to rank the third in 2000 as ever more Taiwan's computer manufacturers move their production into the mainland.[27]

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[24] The sales of China-made integrated circuit chips accounted for only 1% of total global sales. See *China IT & Telecom Report*, (Interfax Information Services, http://www.interfax.ru/english/china it.htm, September 1, 2000), 1.

[25] Barry Naughton & Donald Clarke, *Intellectual Property Rights in China: Evolving Business and Legal Frameworks* (Seattle, WA: National Bureau of Asian Research, 1999), 23.

[26] *Zhongguo dianzi gongye nianjian* [China Electronics Industry Yearbook] (Beijing: Dianzi gongye chubanshe, 1998), 10 & *Zhongguo dianzi gongye nianjian* [China Electronics Industry Yearbook] (Beijing: Dianzi gongye chubanshe, 1999), 97.

[27] *Beijing wanbao* [Beijing Evening News], 28 October 2000 (Internet edition: www.jb.com.cn) & *South China Morning Post*, 30 October 2000 (Internet edition: www.scmp.com).

The more competitive edge in technology for the indigenous sector lies in the software rather than the hardware sector of the industry. A separate software industry in China did not emerge until the early 1990s, however, because the value of software was not widely recognised by computer users or vendors in the 1980s and most software products were sold together with hardware. Entering the 1990s, the software was increasingly separated from hardware, and the rise of a software market ensued.[28] Unlike another rising power in software production, India, where the industry focuses upon software exports or providing offshore services to American and European companies, the Chinese software industry focus upon the domestic and overseas Chinese market. Even though Microsoft still dominates the operating system software, a lot of application software, which require tailor-made designs, cannot use imported software packages. Given this, the foreign software companies tend to employ indigenous companies to undertake "localisation" of their products. The cooperation with foreign companies is a significant part of the industry. The indigenous firms also tend to be able to establish an independent market for local software.

Software manufacturing is neither labour-intensive nor capital-intensive. It is a knowledge-intensive industry in which the high calibre of human resources is the key to development and success.[29] As a result, it is easier for individuals to enter into business provided that they can well master the technique of software engineering, programming and/or have such human resources linkages. Several large-scale software companies

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[28] Jeff X. Zhang & Yan Wang, *The Emergence Market of China's Computer Industry* (Westport: Quorum Books, 1995), 43.

[29] In accordance with the conventional wisdom, here the labour-intensive only refers to the high intensity of manual labour input; the capital-intensive only refers to capital and producer goods input. Actually the knowledge-intensive can be both labour- and capital-intensive in the sense that the labour input is in form of intellect and the human resources are *per se* treated as capital. The labour and the capital are the same thing.

nowadays are founded by individuals without any institutional background in China. Some of them are even the bellwethers in their own software specialities. Some small firms which had only been engaged in the hardware business also have switched to or expanded in the software sphere, in part because marginal profits in hardware sales are dwindling almost to nothing under cut-throat competition.

The emergence of the Internet since the mid-1990s has further boosted the computer industry, alongside a simultaneously developing telecommunications sector. The earliest application of the Internet in China can be traced back to 1986. At that time only some scientific institutions used long-distance dialling to retrieve information from European on-line databases. The milestone in development was the establishment of the Computer Network Information Centre in 1994. Under the support of the State Economic Planning Commission and World Bank loans, a super-computing centre was set up in Beijing. It linked 30-plus sites at the Chinese Academy of Sciences and at Peking and Tsinghua universities with the Internet through optical cable. In that year, there were only about 10,000 Internet users in China. But the growth rate at the end of the 1990s was astonishing. According to the report from the China Internet Network Information Centre, from the end of 1997 to the end of 1999, the user population increased 13 times, from 670,000 to 8.9 million.[30] In addition, over 15,000 websites have been created in China. Domain-name registrations in China rank seventh in the world.[31]

[30] See *Beijing Review* 41, 48 (30 November – 6 December 1998): 8 & *Business Weekly*, 12 March 2000: 5. According to conservative estimates done by other foreign agencies, the user population ranged from 3.79 million to 6.7 million by the end 1999. See Peter Weigang Lu, "Internet Development in China," *Chinaonline*, 31 March 2000 (www.chinaonline.com).

[31] *Beijing Review* 43, 13 (27 March 2000): 20 & "The Name of the Game is … China Ranks No. 7 Worldwide in Domain Registration," *Chinaonline*, 26 May 2000 (www.chinaonline.com).

Although the on-line population in China is anticipated to soon become the largest in Asia, the penetration of the Internet into the general population will remain shallow. It is estimated that about 7% of the population will be on-line in 2005; the comparable figure in Japan is more than 60%.[32] The users in China now are concentrated in a handful of the largest cities: the majority of the users are in Beijing, Shanghai and Guangzhou.[33]

In spite of the weak base of Internet users, this sector has already given rise to a surge of various Internet-related industries. They include the Internet Services Provider (ISP), the Internet Content Provider, web domain registration and web-site design, Electronic Commerce (e-commerce) and so on. The Internet-related industries started to flourish at the very end of the 1990s. For example, websites engaged in e-commerce soared from 100 in early 1999 to 1,100 in mid-2000.[34] By the end of 1999, the e-commerce volume of business hit 200 million yuan.[35] The private ventures constitute a major proportion of the risk-takers in this Internet sector.

The development of e-commerce is now greatly constrained by two factors. The first is poorly developed telecommunications network-building, caused by the monopoly of China Telecom, a state company regulating-cum-engaging in most businesses related to telecommunications. Its monopoly leads to considerably higher Internet access fees than in the United States. The network subscription fee also accounts for a major proportion of the cost for companies that are engaged in various

[32] Peter Weigang Lu, op. cit.
[33] *Zhongguo jingying bao* [China Business], 22 August 2000 (Internet edition: www.cb.com.cn).
[34] *Zhonghua gongshang shibao* [China Business Times], 10 March 2000 (Internet edition: www.cbt.com.cn) & *China Daily*, 21 June 2000 (Internet edition: www.chinadaily.com.cn).
[35] See *Beijing Review* 43, 13 (27 March 2000): 21.

Internet businesses. As a result, the ISPs, which took the lead in the Internet industry from the mid-1990s, all have reported that they are not making any profits yet.[36] In order to hasten the industry's development, the government is increasing inputs into network building and is introducing greater competition in the IT industry. It has established a second company, China United Telecommunication (China Unicom) in 1994, to improve the business environment.[37] The cost of Internet access is also decreasing today, but the situation in this sector of the business context remains far from desirable.[38]

In addition, an inadequate infrastructure for e-commerce is imposing another constraint. Although various on-line clearing systems are now being established by some well-established Internet companies in association with individual banking corporations, most of e-commerce transactions are still conducted through traditional methods. Most people who purchase goods on-line still pay through post offices or pay cash upon delivery. The Internet only helps to accelerate the speed of information flows. In fact, the method of credit card payment is far from popular in China. The reliability of the transactions' security needs to improve. The express delivery business, which just started in China a few years ago, is likewise still backward, which makes on-line purchasing very slow. As a result, e-commerce is largely limited to business-to-business transactions at present.

[36] See *Beijing Review* 41, 48 (30 November – 6 December 1998): 10. Besides the cost, as the China Telecom manipulates the infrastructure of the network, this point of vantage makes it able to offer relatively cheaper services to customers. The competition is very unfair to other companies.

[37] The China Unicom has only broken the monopoly in paging and telephone services by now. It is only slightly engaged in the ISP service.

[38] While I was conducting the fieldwork in 1999, the Internet access fee for non-corporate users had just been reduced from 10 yuan to 4 yuan per hour.

Despite these many constraints, investors and entrepreneurs have not lost their interest in this virgin territory. In spite of the fierce competition in certain markets, like the PC market, the markets are far from saturation and prospects are very optimistic. It is estimated that overall, the proportion of PCs to the national population was only 1 to 120 in 1998.[39] Among urban families which possess a PC, only 12% of them were on the net according to a survey conducted in 1999,[40] and everybody anticipates that the IT sector will expand considerably. Entrepreneurs in several cities are taking a pivotal role in this development, among which are those from the two cities in this study: Beijing and Guangzhou.

The Private Economy in Two Cities: Beijing and Guangzhou

Beijing is one of four centrally administered cities (*zhixiashi*) in China — equivalent to a province in administrative ranking — and is, of course, also the seat of the central government. It is located at the northern fringe of the North China Plain surrounded by Hebei Province and near another centrally administered city, Tianjin. Guangzhou is the capital of Guangdong Province — a deputy provincial level city. It is strategically located at the vertex of the Pearl River Delta, a pivotal point of communication in South China derived from its historical role as a treaty port in modern China. The human resources available to Guangzhou are much less than in Beijing, in that Beijing is the national hub of tertiary education. There are 65 tertiary education institutes in Beijing and 35 of them are designated as national key-point (*zhongdian*) tertiary institutes. This

[39] *Shichangbao* [Market Daily], 25 September 1999: 3.
[40] *Shichangbao* [Market Daily], 1 April 1999: 8.

constitutes a quarter of all national key-point tertiary institutes.[41] Guangzhou is also an important education hub in South China, with 26 institutions of higher learning.[42] Yet Guangzhou is obviously put in the shade by Beijing.

However, Guangzhou enjoys a comparative advantage due to its proximity to Hong Kong and the close connections of its residents with Hong Kong people and overseas Chinese. This facilitates the development of foreign investment and trade. The reform policy in the 1980s was especially favourable to Guangdong Province by allowing it to pioneer foreign trade and to absorb foreign investment, and by granting it considerable fiscal autonomy. As its capital, Guangzhou was also one step ahead of many other cities in initiating economic reforms. It was one of the coastal open cities in 1984 and was allowed to have independent planning (*jihua danlieshi*) from 1985 to 1993, which granted it provincial-level economic power and direct access to the central government in economic planning.

Despite enjoying more advantages, Beijing has not outperformed Guangzhou in terms of economic output. Even though Guangzhou has a considerably smaller population and area, in 1998, the GDPs of Beijing and Guangzhou ranked second and third respectively among all cities. Since 1988 Guangzhou has overtaken Tianjin as the third largest urban economy in China after Shanghai and Beijing. In some aspects, Guangzhou outdid Beijing. In 1998, the industrial output and the utilisation of foreign investment of Guangzhou were slightly larger than those of Beijing. The per capita

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[41] Chen Jian, *Fuwu Zhongguo — pojie shoudu jingji nanti* [Serving China — Solving Economic Issues of Capital] (Beijing: Zhongguo jiancha chubanshe, 1998), 151.
[42] *Zhongguo chengshi tongji nianjian* [Urban Statistical Yearbook of China] (Beijing: Zhongguo tongji chubanshe, 1998), 278, 296.

income of Guangzhou residents was higher than that of both Shanghai and Beijing residents.[43]

The economic growth of both metropolises in the post-Mao era has relied upon the development of their suburban districts. In Beijing, the development of Haidian District, northwest of the city centre, became a point of departure for the high-tech industrial development of China. From the early 1980s, Zhongguancun, situated in Haidian and dubbed the Silicon Villey of China, took the lead to develop technology-based industries under the auspices of the major research institutes and universities that are densely located in Haidian. In 1988, the Beijing Experimental Zone for New Technology Industry was established in Haidian to promote and facilitate the development of the high-tech industries. This was the first high-tech industrial zone in China. Its establishment imitated the Stanford Industrial Park in Silicon Valley, in which an innovative milieu was deliberately nurtured for techno-entrepreneurs. Moreover, almost 80% of the enterprises registered in the Zone engage in electronics business.[44] Entering the 1990s, four other similar industrial zones were established in other suburban districts and counties surrounding the city centre.[45] In 1999, these dispersed zones were further integrated into the Zhongguancun Science Park (ZSP) (See Figure 4.5).

Guangzhou's new development zone mainly stretches eastward, in Huangpu District, 35 kilometres from the city centre. In 1984, the Guangzhou Economic and

[43] *Guangzhou tongji nianjian* [Guangzhou Statistical Yearbook] (Guangzhou: Guangzhou nianjianshe, 1999), 535.

[44] www.zhongguancun.com.cn/zgc_web/yqgk/yqgk_jjfz_qy.htm

[45] The other four Zones are Fengtai Zone in Fengtai District, Changping Zone in Changping County, Yizhuang Sciences and Technology Park in southeast of Beijing and Electronic City in Chaoyang District.

Technological Development Zone in Huangpu was established mainly to attract foreign business, as a counterpart to the Shenzhen Special Economic Zone. In between Huangpu and the city centre, a suburban area of 108.3 square kilometre was appropriated to establish Tianhe District in 1985 as an extension of the old city centre. In 1991, the Tianhe Scientech Park (TSP) was established in the district, somewhat like a small Zhongguancun. Huangpu and Tianhe are now two significant economic powerhouses for Guangzhou. In my field studies, I mainly visited private enterprises in the Haidian District of Beijing, and the Huangpu and Tianhe Districts of Guangzhou (See Figure 4.6). These are not only the spearheads of municipal economic growth but also cradles for the revival of the private sector.

Beijing — from Laggard to Emulator vs. Guangzhou — Overshadowed Pioneer

In spite of its favourable conditions as the political and educational centre of China, Beijing did not lure people into private business. As the capital of a socialist country, it tended to keep private entrepreneurs at a distance from Beijing in the first decade of the reforms. By contrast, Guangzhou is far away from the political centre, was one of the earliest open cities, and has proximity to "capitalist" Hong Kong. Hence, the ideological constraints upon private economic development were already more relaxed at the very beginning of the reforms.

The government's and people's attitude towards private business in the two cities posed a great contrast. In the 1980s, the development of the private economy in Beijing was very sluggish. In 1981, the number of *getihu* only reached about 6,000, while there were 20,000 in Guangzhou. Most of these businesspeople in Beijing were originally retirees and unemployed persons. Youth awaiting job assignments (*daiye* *qingnian*) constituted a very small proportion of the *getihu*. As capital residents, Beijing youths felt more ashamed of becoming individual businesspeople.[46] By contrast, as early as 1974, 994,000 young people who were rusticated during the Cultural Revolution began to return to Guangzhou. But the government and state enterprises were already overstaffed, unable to absorb the new workforce. Fearing social unrest, allowing them to set up private businesses and collective enterprises provided a solution for the municipal government. Moreover, the government already connived at private businesses employing more than seven wage labourers.[47]

By the end of 1987, Guangzhou had 1,688 "big" *getihu* business units, which employed more than seven persons.[48] In Beijing, there were only 805 such "big" *getihu* business units on the eve of the legalisation of private enterprises. Right after the implementation of the Provisional Regulations on Private Enterprises, only 8 *getihu* business units in Beijing were re-registered as private enterprises. Further, only 694 of the above "big" *getihu* business units remained after the promulgation of the Regulations.[49] This unusual contraction reflected the sensitivity of Beijing's businesspeople to the political turmoil in 1988-89. By contrast, in Guangzhou there were 579 private enterprises registered by the end of 1988. Among them, 78 were registered limited companies. The total registered capital of all types of private enterprises amounted to 78 million yuan. Of these enterprises, 579 were industrial enterprises, accounting for 51%.[50] The slight preponderance of industrial enterprises

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[46] Xianmin Shi, "Beijing's Privately-owned Small Businesses: A Decade's Development," *Social Sciences in China*, 1st issue (Spring, 1993): 155.
[47] Ezra F Vogel, *One Step Ahead in China: Guangdong under Reform* (Cambridge: Harvard University Press, 1989), 99-100.
[48] *Guangzhou tongji nianjian* (1988), op. cit., 118.
[49] *Shoudu jingji* [Capital Economy], 76 (October, 1997): 30.
[50] *Guangzhou nianjian* [Guangzhou Yearbook] (Guangzhou: Guangzhou wenhua chubanshe, 1989), 371.

boiled down to the fact that industrial plants usually employed more workers than other sectors and so were more often eligible to re-register their enterprises.

In the first four years of the 1990s, the development of registered private enterprises in Beijing lagged behind many other cities. Despite being a provincial-level city, the number of its registered private enterprises was much fewer than all other cities that had been granted independent planning in 1990.[51] This sluggish growth should be attributed to the special status of the national capital, which had just been swept by the political campaign against Bourgeois Liberalism. Administrative control over private economic development remained especially strict in Beijing. For instance, before 1993, the registration of all enterprises had to be approved by corresponding economic departments of the government, and all of the enterprises had to find a *danwei* to be "attached to" (*guakao*).[52] In other words, if one had no *guanxi* with any state economic sector or state agency, it was unlikely one could set up an enterprise in the capital.

In spite of the slow development of the "formal" private sector, the quasi-private enterprises or spin-offs had become well developed since the 1980s. They were mainly composed of technology-based industry. Reportedly, these so-called *minying* technology-based enterprises had already reached 552 in 1986. Most of them were registered as either collective or state enterprises and were concentrated in Haidian District.[53] In addition, there existed a great pool of well-educated would-be

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[51] *Zhongguo gongshang tongji ziliao* (1990), op. cit., 54-6.
[52] *Zhonghua gongshang shibao* [China Business Times], 3 April 2000 (Internet edition: www.cbt.com.cn) & Interviewee 2.
[53] Wang Jianhua (ed.), *Minying keji qiye de fazhan* [Development of People-operated Technology Enterprises] (Beijing: Jingji kexue chubanshe, 1996), 29.

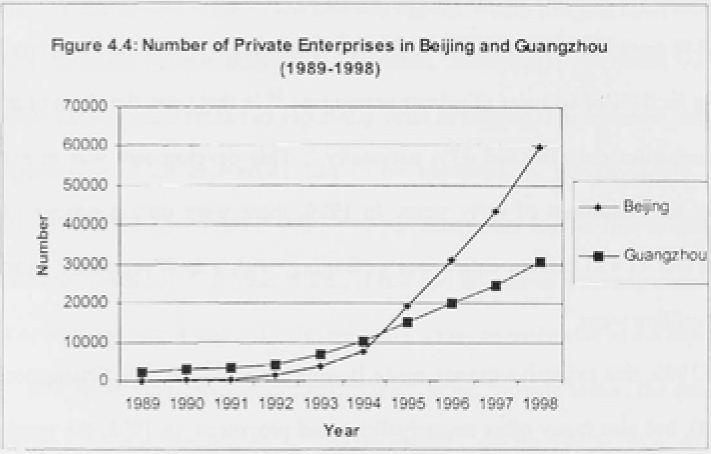
entrepreneurs who were waiting for a favourable environment to start up their own business career.

Since the implementation of the Company Law in July 1994, the private sector in Beijing has experienced an extraordinary growth. Most of the new private enterprises leaped into the category of limited companies. After 1994, the distribution of types of private enterprises in Beijing was extremely skewed. In 1995, the number of registered private enterprises surged by 159%, leaping from 7,509 in 1994 to 19,420. Among them, 10,248 were limited companies registered in accordance with the Company Law, accounting for 53% of all types of private enterprises.[54] In that year, the share of private limited companies only reached 37% nationally.[55] This development was in extreme contrast to the conditions of early years. In 1989, there were only 5 private limited companies out of 123 private enterprises in Beijing, with a total registered capital of only 15.3 million yuan.[56]

In 1995, this explosive growth made Beijing overtake not only Guangzhou (see Figure 4.4), but also many other municipalities and provinces. In 1998, the number of private enterprises in Beijing reached 59,690 of which 52,099 were limited companies, rising to 87% in share. The registered capital hit 36.3 billion yuan.[57] This extraordinary development should be attributed first to the further liberalisation after Deng's southern tour and second to the promulgation of the Company Law. The rapid growth was apparently a direct response to the latter, because almost 90% of the newly established

[54] *Zhongguo gongshang xingzheng guanli nianjian* (1996), op. cit., 146.
[55] Ibid., 146, 416.
[56] *Zhongguo gongshang xingzheng guanli tongji sishinian* [Forty Years of the Industrial and Commercial Administration of China] (Beijing: Zhongguo tongji chubanshe, 1992), 157-8.
[57] *Zhongguo gongshang xingzheng guanli nianjian* (1999), op. cit., 148.

private enterprises were registered in accordance with the Company Law. The de-emphasis upon ownership in the new law encouraged politically sensitive Beijingers to open a private firm.[58] As noted in the last chapter, the rapid growth of private limited companies after 1994 was a nationwide phenomenon, but Beijing seems to be more sensitive to institutional change.



Sources: *Zhongguo gongshang xingzheng guanli nianjian* (1993-1999), op. cit.; *Zhongguo gongshang xingzheng guanli tongji sishinian* [Forty Years of the Industrial and Commercial Administration of China] (Beijing: Zhongguo tongji chubanshe, 1992); *Beijing gongshang guanli* [Beijing Industrial and Commercial Administration], 91 (May, 1997): 44-5; *Beijing gongshang guanli* [Beijing Industrial and Commercial Administration], 101 (March, 1998): 4.; *Guangzhou nianjian* [Guangzhou Yearbook] (Guangzhou: Guangdong renmin chubanshe, Guangzhou nianjianshe, 1990-9).

Guangzhou was quite different from Beijing. For the private economy in China, Wenzhou was usually taken as the hallmark. However, focusing upon the ***urban*** private economy, one should have a look at Guangzhou first. In 1990, the development of private enterprises in Guangzhou topped all other independently planned cities and

[58] *Shoudu jingji* [Capital Economy], 76 (October, 1997): 33.

centrally administered cities in the number of enterprises and investors, registered capital, and turnover.[59] In spite of the unfavourable political environment in 1990, the annual growth rate in the number of private enterprises, investors and employees maintained a high record — 36%, 30% and 37% respectively.[60]

Compared with other cities, the Guangzhou government took a more lenient attitude towards the private sector. Its government was determined to make use of the private sector to boost the municipal economy from the outset. As early as 1989, the government promulgated regulations to promote the growth of private enterprises. The measures included opening more previously restricted business areas to the private sector, and granting tax reductions and tax holidays to newly established or manufacturing enterprises. The government gave preferential treatment to indigenous private enterprises that processed orders placed by foreign companies and those that formed joint operations or joint ventures with foreign companies.[61] In addition, the government issued regulations in 1992 to allow wholly individually-owned and partnership enterprises with registered capital of 30,000 yuan or above to possess legal person status.[62]

In 1993, the Municipal Party Committee and government jointly promulgated the "Resolution on Accelerating the Individual and Private Economy." Ahead of the central policy, the resolution defined the private economy as an "important component

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[59] There were 14 centrally planned cities. Besides Guangzhou, they were Shenyang, Dalian, Changchun, Harbin, Nanjing, Ningbo, Xiamen, Qingdao, Wuhan, Shenzhen, Chengdu, Chongqing and Xi'an. See data about the private economy in these cities in 1990 in *Zhongguo gongshang tongji ziliao* (1990), op. cit., 54, 56-7.

[60] *Guangzhou nianjian* (1991), op. cit., 418.

[61] *Guangzhoushi fagui guizhang quanshu* [Collection of Rules and Regulations of Guangzhou] (Guangzhou: Guangdong renmin chubanshe, 1996), 96-8.

[62] Guangzhou Government Document (1992) no. 72.

of the national economy and one of the mainstays of the socialist market economy," while the Party centre did so only as late as 1997. In order to promote the private economy, more restrictions were lifted, all business areas were open to the private sector, and the government launched a trial of granting select manufacturing private enterprises permission to possess independent rights to export and import. These rights were nationally granted in 1999. In addition, the private sector was allowed to buy SOEs. The government also set up an experimental zone that promoted the individual and private economy in Baiyun District, a suburban district situated to the north of the city centre.[63]

In October 1997, the municipal government issued the "Regulations for Protecting Rights of Private Enterprises," which were approved by the Guangdong People's Congress Standing Committee. This was the first set of such local regulations to formulate concrete principles to respect the legal property rights of non-publicly-owned economic organisations and to place private and public enterprises on an equal footing vis-à-vis administrative rules. The regulations stipulated that no *danwei* or individual could illegally intervene in the operation of private enterprises nor could encroach or infringe on the legal property of private enterprises, while the directors, supervisors, business partners and staff of private enterprises were prohibited from making use of their positions in the enterprises to take bribes. Elsewhere in China, the state authorities generally have made light of the protection of private property. For instance, one would only be charged with committing corruption if the misbehaviour concerned infringing upon public property. The concept of "corruption" (*tanwu*) is not

[63] *Geti siying jingji falü fagui wenjian xuanbian* [Selected Laws and Regulations on Individual and Private Economy] (Beijing: Zhongguo zhihua chubanshe, 1998), 860-4.

applied to the same behaviour in private organisations. Hence, the new regulations were a breakthrough in terms of official attitude towards private property.

However, the pioneering practices of Guangzhou have not spurred an upsurge of its private economy as in Beijing. Its top position fell to eighth in terms of the number of private enterprises in 1998. The loss of the leading position was reportedly attributed to the poor implementation of the above policies. For instance, by early 1998, there had been only two private enterprises possessing independent rights to export and import.[64] The burden of administrative fees remained very heavy. Red tape was still hindering business transactions.[65] Cases of infringements of private property were common.[66]

According to the official statistics, on the other hand, the performance of private economic growth in Guangzhou was also impressive. The annual growth rate in the number of private enterprises averaged 36% for the first nine years of the 1990s, while the share of limited companies rose to 76% in 1998.[67] My interviews suggest that the provincial capital remains one of the most favourable places in South China for business investment in light of the efficiency of the state administration. The composition of investors attests to the validity of this impression. According to the official statistics, up to mid-1999, a quarter of the private enterprises in Guangzhou had been opened by outsiders, i.e. non-Guangzhou residents. Approximately another quarter were jointly opened by native residents and outsiders.[68] As a major trading centre in South China, Guangzhou is a desirable place for investment by domestic entrepreneurs from outside

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[64] *Guangzhou ribao* [Guangzhou Daily], 13 May 1998: 2.
[65] See *China News Service* (27 August, 1998) (www.chinanews.com).
[66] See *Nanfang ribao* [Nanfang Daily], 23 November 1998: 13; *Renmin ribao* [People's Daily] (South China News), 23 November 1998: 1.
[67] *Guangzhou nianjian* (1991-9), op. cit.
[68] *Yangcheng wanbao* [Yangcheng Evening News], 16 October 1999: 1.

the provincial capital. The above contradictory images of the investment environment there reflect the comparative advantage of Guangzhou against many places in the north, even though the environment of Guangzhou is not satisfactory enough.

Guangzhou suffered from a competitive disadvantage within the economic landscape of Guangdong Province. First of all, three of the four Special Economic Zones in China are located in Guangdong — Shenzhen, Zhuhai and Shantou. In addition, counties in the Pearl River Delta, including Dongguan, Nanhai, Zhongshan and Shunde, took off economically in the 1980s and have achieved a high level of industrialisation and urbanisation. These newly developed cities not only attracted foreign investment but also bolstered the development of the indigenous private sector, acting head-on as competitors with Guangzhou. Hence, they tapped a high proportion of the economic resources available in Guangdong. This is especially so with Shenzhen; its GDP is now catching up with Guangzhou's. The number of private enterprises in Shenzhen overtook Guangzhou in 1995 and reached 34,000 in 1998, while Guangzhou's trailed it at 31,000.[69]

If Guangzhou could keep one step ahead of other cities outside Guangdong, it could only keep less than a step ahead of other cities within Guangdong. The preferential treatment offered by the Guangzhou government could be copied by neighbouring cities very quickly. For instance, similar regulations for protecting private enterprises were promulgated in Zhuhai in September 1998.[70] The government policy towards the private sector does not count very much if the offers by adjacent places are

[69] *Zhongguo gongshang xingzheng guanli nianjian* (1999), op. cit., 225, 231.
[70] Ibid., 232.

more or less the same. Moreover, the legacy of a bloated bureaucratic structure in the provincial capital put Guangzhou at a disadvantage.

In contrast to the situation in South China, Beijing in North China faces far less competition than Guangzhou. Tianjin, as noted above, has been overtaken by Guangzhou not only in overall economic performance but also in the private economy, let alone in comparison with Beijing. Beijing has been playing a leading role in developing the private sector in this region from the mid-1990s onward.

Interestingly, except for specific policies towards *minying* technology-based industries, the Beijing government had not actively hastened private economic development until 1998 after the Party centre had recognised the non-public sector as an "important component" of the national economy.[71] In general, the economic policy of the Beijing government usually strictly complied with the central line, while the southeast coastal provinces took the lead to break that line. Although the ZSP creates a "greenhouse" environment for technology-based industries, in which semi-private and private enterprises account for the majority of such firms, the preferential treatment granted by Guangzhou's TSP does not lag behind Beijing's ZSP and is even better. The higher calibre of human resources available in Beijing is the major impetus to the upsurge. Better-educated people are increasingly more inclined to exploit their career outside *danwei* that offers low remuneration and no room for their own initiative. Setting up their own private business is one of the options. This results in a unique mode of development of the private sector in Beijing. The private entrepreneurs there

[71] The Beijing Municipal Planning Commission et al. promulgated in September 1998 "Opinions on Encouraging Beijing's Individual and Private Economic Development." See the Opinions from www.mystar.com.cn/p9205.html.

tend to be better educated, especially among the entrepreneurs in Haidian District, where around 80% of private entrepreneurs possess a bachelor degree or above.[72] They concentrate upon technology related businesses. It was reported in early 2000 that in Beijing there were around 20,000 private enterprises engaging in computer applications, scientific research and technology development, accounting for a quarter of all private enterprises in the capital.[73]

By the same token, private enterprises in Haidian District constitute a high proportion of all the private enterprises in Beijing. In April 1998, they accounted for 26% of all Beijing's private enterprises. This was 34-odd times the number in the least developed district Yanqing County in northern Beijing, and eight times Xuanwu District at the city centre.[74] The private enterprises in Haidian were proliferating at an astonishing speed in the past few years. From 1995 to mid-1999, the number of private enterprises in the district had soared 18 times.[75] The outstanding performance of Haidian should be attributed to its special location as the hub of higher education. The municipal government usually takes Haidian as a point of trial implementation of reform measures that further reinforces the capacity of the district to absorb private investment. The government's industrial policies ever more leaned towards promoting high-tech industries that are densely located in the district.

Last but not least, many "fake" collective technology-based or so-called *minying* enterprises began to re-register themselves as private enterprises at the end of the 1990s. About 50% of the collective enterprises in Beijing, including a lot of technology-based

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[72] *Shoudu jingji* [Capital Economy], 90 (December, 1998): 7.
[73] *Beijing ribao* [Beijing Daily], 2 March 2000 (Internet edition: www.jb.com.cn).
[74] *Shoudu jingji* [Capital Economy], 97 (July, 1999): 10.
[75] *Beijing ribao* [Beijing Daily], 29 July 1999 (Internet edition: www.jb.com.cn).

firms, either transformed themselves into shareholding cooperatives or re-registered themselves as limited companies through mid-1999.[76] It should be noted that the output of *minying* technology-based enterprises also constitutes a considerable share of the GDP in the capital. The technology-industry-trade revenue of the *minying* technology-based enterprises already accounted for 23% of its GDP in 1997.[77]

Haidian's phenomenon is not exactly replicated in Guangzhou. The great contrast in the pool of technical personnel from higher education and research institutes is a major cause. In addition, well-paid position offered by a large number of foreign-funded companies in Guangzhou provide a substitute for taking business risks and absorb a considerable portion of the well-educated workforce. According to interviews with people in Guangzhou, it seems that the native residents in general prefer to secure employment job with foreign-funded companies rather than to take a business risk themselves if they have two such options. Conversely, businesspeople from elsewhere in China have a greater propensity to pick Guangzhou as a base for entrepreneurship. That may account for why a high proportion of the private enterprises in Guangzhou are owned by "outsiders."

If Beijing is compared to Bangalore — India's Silicon Valley — Guangzhou can be compared to Hyderabad, which is attempting to catch up with Bangalore in the IT industry. Likewise, the Guangzhou government is bolstering the development of high-tech industry, especially focusing upon computer software. Based upon the TSP, the Tianhe Software Park was set up in August 1999 to specialise in the development of software. Most of the software and related enterprises in Guangzhou are non-state firms.

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[76] *Beijing jingjibao* [Beijing Economic Daily], 1 August 1999: 1.
[77] Chen Jian, op. cit., 176.

According to an official investigation in 1999, 90% of 957 such enterprises were *minying* enterprises.[78] By the same token, Tianhe is one of the districts in which the private sector as a whole is thriving. In 1998, the number of private enterprises registered in Tianhe District ranked second in the metropolitan area, with most of the high-tech enterprises located in Tianhe.[79] Comparatively speaking, the distribution of private and technology-based enterprises is relatively even, not as skewed as in Beijing.

Comparing the paths of private economic development in the two metropolises, it is interesting to note that local preferential policies towards the private sector did not play a determining role in hastening the growth of the private sector, though macro-economic liberalisation did spur an overall acceleration of development, shown in the last chapter. The economic landscape of the two cities overrode other factors in leading to this contrasting performance. However, it does not follow that the local governments have had nothing to do with it. Increasingly significant industry-oriented policies are shaping the private sector from another side. This dimension will be discussed in Chapter Seven. By and large, Beijing as the emulator and Guangzhou as the pioneer are heading in the same direction of development — high-tech industries in which private entrepreneurs are taking advantage of the policy line to expand the niche for the private economy. The rest of this dissertation will focus upon how this specific group of entrepreneurs and their enterprises behaved in the 1990s.

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[78] *Guangzhou ruanjian chanye fazhan xianzhuang diaocha baogao* [Investigation Report on the Development of Software Industry in Guangzhou], done by Guangzhoushi ruanjian chanye xietiao gongzuo xiaozu.

[79] *Guangzhou tongji nianjian* (1999), op. cit., 455.

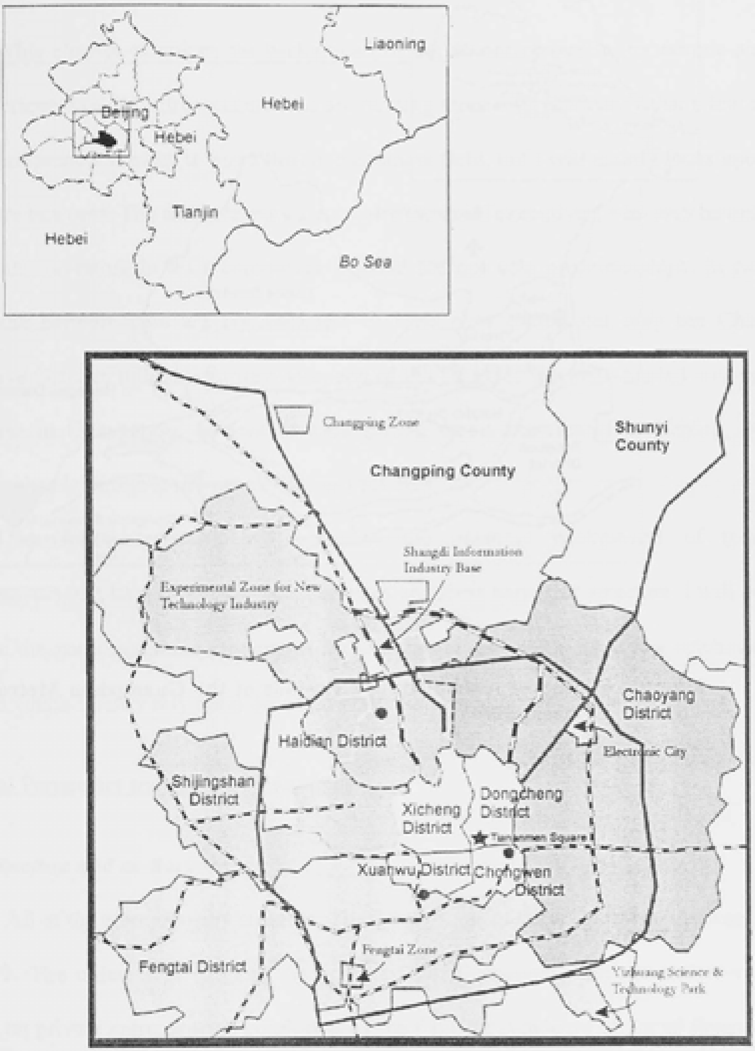

Figure 4.5: Map of the Beijing Metropolitan Area & Zhongguancun Science Park, 1999

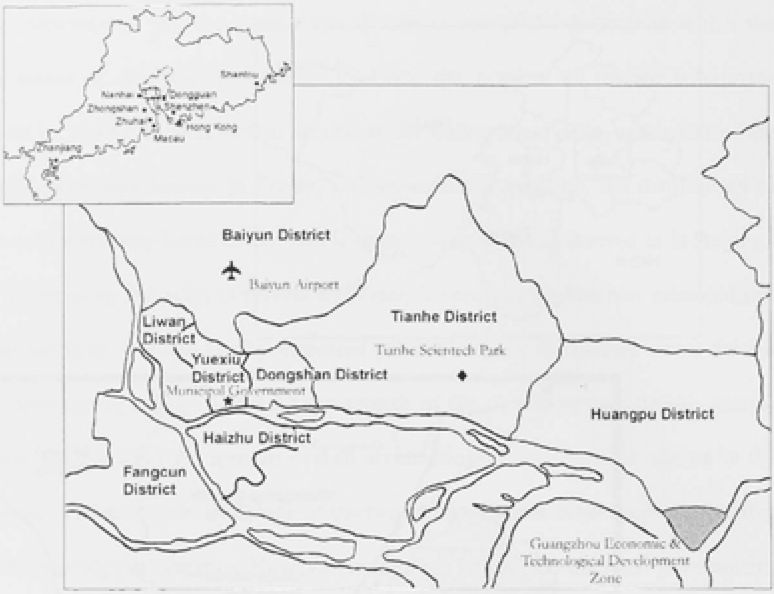

Figure 4.6: Map of Administrative Regions of the Guangzhou Metropolitan Area, 1999

Chapter 5: The Background and Corporate Structure of Enterprises

This chapter examines the background of the 50 enterprises in my sample and the experiences of the entrepreneurs who are running them. I should clarify that a few of these entrepreneurs invest in more than one business field, but I will mainly focus upon their core business. The entrepreneurs are usually the chief executives, who may be only one of the investors in their enterprises if these are not sole proprietorships. In two cases, the entrepreneurs are not investors of their own capital but only the Chief Executive Officers (CEOs). Furthermore, one of the 50 cases is a state-funded *minying* enterprise in Guangzhou. In another case among those interviewed in Beijing, the company headquarters is in Fuzhou, Fujian Province.

The following pages will examine the personal background of these entrepreneurs, the background of the enterprises and their corporate structure. I will not disclose the names of these enterprises and entrepreneurs except for a few celebrated cases in which I partly rely upon documentary materials.

Personal Particulars and Personal Resources

Age Structure and its Backdrop

All of the entrepreneurs are male. The average age of these entrepreneurs was 35 in 1999. The oldest was 62, and the youngest 24. Compared with the nation-wide survey on private entrepreneurs conducted by the Chinese Academy of Social Sciences

(CASS) in 1997, whose samples' average age was 40.5,[1] my sample was quite young. If the oldest entrepreneur, the extreme case, were expunged from the list, it would drop to 31.5. It should be noted that 29 entrepreneurs out of these cases were born in the 1960s and 10 were born in the 1970s. These 39 entrepreneurs grew up in a relatively favourable era. As one of the entrepreneurs, Wang Wenjing, the president of one of the top software companies, Ufsoft Group, who was born in 1964, said with a sense of gratitude to a newspaper, "I haven't experienced the three-year natural disaster (1959-61); I only have a vague memory about the Cultural Revolution but just caught the good era of reforms and opening, caught the resumption of university admissions, caught the regaining of respect for knowledge and talents, caught [the chance of permitting] individuals to start their own businesses...."[2] What Wang said aptly depicted the politico-social background of his generation of entrepreneurs. They belonged to a lucky generation in the sense that the political and social factors were helpful for them to become specialised entrepreneurs. Different from the preceding generation, they never experienced the mental and psychological pressures generated by incessant political campaigns, especially the Cultural Revolution. They were relatively free from ideological constraints when they pursued their careers outside a *danwei*. As for the remaining 11 entrepreneurs, except for the oldest case, they were eyewitnesses rather than participants of the Cultural Revolution, because they were mostly born in the second half of the 1950s and were still children during the political turmoil.

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[1] Zhang Houyi & Ming Zhili (eds.), *Zhongguo siying qiye fazhan baogao* (1999) [Report on the Development of China Private Economies (1999)] (Beijing: Shehui kexue wenxian chubanshe, 2000), 105.

[2] *Beijing wanbao* [Beijing Evening News], 3 October 1999 (Internet edition: www.jb.com.cn).

Education and Career Paths

Just as the entrepreneur Wang Wenjing pointed out that his generation had better access to an education, the entrepreneurs in this study had indeed received a good education. Forty-two entrepreneurs have obtained bachelor degrees or above (84%), whereas the CASS survey showed only 20.2%.[3] None of my cases were among the earliest post-Mao urban *getihu* businesspeople who launched their own businesses in default of employment opportunities. Nonetheless, many of these entrepreneurs started their own businesses at youngish ages. Omitting one case who was a peasant without much education, the youngest business starter launched his own business at 20, while he was still studying at school. Another, who at 21 was an undergraduate, quit his studies at university in order to concentrate upon his business start-up. Some of the other entrepreneurs claimed that they had done part-time jobs during their university studies and accumulated seed capital through this.

The entrepreneurs' experience of employment before launching their first business was usually not rich. Only those who started working during the 1980s and before accumulated a considerable work experience. Of the 20 entrepreneurs who started working during the 1990s, only 5 cases had more than 3 years of experience of prior employment (See Table 5.1). This short experience of the youngest entrepreneurs reflected the significant change in the notion of a career among the new generation, who no longer stuck to the job security offered by the state. This is especially true for the IT specialists, who want to pursue their own initiative, whereas the state sector was unable to provide them with sufficient room. Among my cases, 18 entrepreneurs had job

[3] Zhang Houyi & Ming Zhili, op. cit., 106.

experience in non-state or foreign-funded enterprises. They quit the assigned jobs or declined the state's job assignment to seek another job by themselves. The abandonment of job assignments occurred among those who started working during the 1990s. The others, who had worked in the SOEs or state agencies, can be divided into two groups. The first group was composed of those who started businesses in the second half of the 1980s. They quit their state jobs propelled by the nation-wide enthusiasm for *xiahai* (diving into the business sea) around 1988. The second group was composed of those who started working in the 1990s. They quit their jobs because of the gloomy prospects for career development in the "traditional" job. The opportunity cost of quitting the state job is getting progressively lower and lower.

A particular feature of my cases is that many of these entrepreneurs had job experience in higher education or research institutes. This is not peculiar given that most of these entrepreneurs embarked upon IT businesses. Beijing and Guangzhou shared the same experience in this respect with other technopolises over the world.[4] Elsewhere nowadays, well-known entrepreneurs have spun off from jobs in universities and research institutes. Starting from the mid-1980s, they quit their jobs there and started their own firms so as to turn their research products into commodities.

This path of development was more manifest among the cases from Beijing. Nine of the Beijing entrepreneurs had research and/or teaching experience in universities or research institutes, while there were only four such cases in Guangzhou. The entrepreneurs in Beijing in general were better educated than those in Guangzhou. 13 of the Beijing enterprises had at least one investor with or earning a Master's or

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[4] Manuel Castells & Peter Hall, *Technopoles of the World: The Making of 21st Century Industrial Complexes* (London: Routledge, 1994).

doctoral degree, while there were only 6 in Guangzhou. As noted in the last chapter, Beijing is the national hub of various higher education and research institutes. This well-educated group of entrepreneurs was more socially respected than other groups of businesspeople, who were sometimes disparaged as nouveaux riches and crooks.

Table: 5.1: The Employed Experience of Entrepreneurs (N=46)*

Years of Employed Work Experience before Launching First Business	Entrepreneurs Started Working before the 1990s	Entrepreneurs Started Working from the 1990s
Never employed		1
Less than 1 Year	1	5
1 to 3 Years	6	9
4 to 5 Years	6	1
More than 5 Years	13	4
Total	26	20

*The remaining four cases are irrelevant. Three of them are CEOs or employed managers. The remaining one has both employed and self-employed business experiences from the outset.

Despite generally short experiences of prior employment, many of these entrepreneurs did draw relevant resources from their pre-business education and work experiences. There were respectively 30 and 27 entrepreneurs whose businesses were, with varying degrees, related to their academic training and previous work experiences. Combining the two factors, 36 cases (72%) linked their businesses with to their previous experiences. It should be noted that a good command of computer knowledge and technique is often the key to launching business in the IT industry, while sensitivity to market demand is the primary, even the sole key for many other industries.

Origins, Residency and Business Mobility

While professional training, education and work experiences are often crucial to these entrepreneurs, the ascribed status basically played no distinctive role in nurturing their career. In terms of origins, 34 out of 48 relevant enterprises (71%) involved entrepreneurs who were non-native to the two cities. 34 out of 47 relevant cases (72%) obtained full residencies (*hukou*) in Beijing or Guangzhou.[5] Some of them were not native. They obtained residency due to pursuing post-graduate degrees there or being assigned to work there.[6] In other words, 13 entrepreneurs were neither native nor local *hukou* holders. This indirectly indicates that the parents, families, and other close relatives of these non-native entrepreneurs generally have laid no critical foundation for their building of businesses, even though some of them had absorbed their family members or close relatives into their firms. For one thing, they did not live with their parents, as the latter almost all kept living in their home towns. For another, no one in all of these entrepreneurs came from rich or senior cadre families. Indeed, not a few of them sprang from peasant stock. The family heritage looked to play no important function in their career pursuits. If anything, the fathers of two entrepreneurs were also managing businesses; therefore, their fathers to a certain extent shaped the forming of their own entrepreneurship. But these two interviewees alleged that their families invested nothing in their firms,[7] and they were in unrelated businesses. This finding is in line with CASS's survey.[8] Even for the native-city entrepreneurs in my cases, their

[5] *Hukou*, or known as the household registration is an administrative system to control rural-urban migration by means of mandatory allocation of urban residencies and jobs. During the era of planned economy, with an urban *hukou*, one was entitled to get access to all life necessities from their habitations, including housing, food rationing, school education, job, etc. For its origin and transformation, see Tiejun Cheng & Mark Selden, "The Origins of Social Consequences of China's *Hukou* System," *The China Quarterly*, 139 (September, 1994): 644-68 & Hein Mallee, "China's Household Registration System under Reform," *Development and Change* 26, 1 (January, 1995): 1-29.

[6] For non-native undergraduates, they are not entitled to obtain the residency after the graduation.

[7] Interviewees 3 and 50.

[8] Zhang Houyi & Ming Zhili (eds.), *Zhongguo siying qiye fazhan baogao* (1987-1998) [Report on the Development of China Private Economies (1987-1998)] (Beijing: Shehui kexue wenxian chubanshe, 1999), 156.

supposed familiarity with local resources gave them no conspicuous advantage over the non-native entrepreneurs. Admittedly, the IT industry is a relatively open business and closely linked to overseas rather than local resources, and therefore, being a native-city entrepreneur does not necessarily entail any advantage.

As a usual practice, many of the entrepreneurs among my cases relied upon loans from kith and kin to help establish their firms, but this could not be regarded as a critical resource, because it was always stopgap assistance, not a real financial input, and they needed to pay the money back in a short time.

It should be noted that the capitalist economy in China had vanished for almost 30 years before its revival in the early 1980s. It was normal that most of these private entrepreneurs started from scratch. Although there are some young "bureaucratic capitalists" who were children or close relative of senior cadres, so-called princelings (*taizidang*), they are usually engaged in such "black" economic activities as state-capital drainage, underground and rent-seeking businesses. They should be separated from this study that just focuses on productive businesses.

Three specific cases in Guangzhou are noteworthy when discussing origins and residency. First, two of the enterprises were not originally established in Guangzhou but in the places of origin of the entrepreneurs. One of these entrepreneurs was assigned to work in a state factory in Guangzhou after his graduation from university. But after one year, he quit the job to launch a small factory in his home town, Changsha in Hunan Province. This went bankrupt after half a year, and after that he worked in two non-state companies in Shenzhen and Guangzhou in tandem, and simultaneously embarked upon trading businesses in Hunan. In 1996, he established a new company with his friends in

Changsha. When I interviewed him, he had just managed to move the company's headquarters from Changsha to Guangzhou. He explained that this decision was based upon two factors. First, all of the shareholders including him held a Guangzhou *hukou*. Second, Guangzhou was an important economic hub where a higher calibre of human resources was available. The Changsha government had urged him to stay, but he ignored the request.

The fact that he had been granted a Guangzhou *hukou* seemed crucial in his decision-making. But his choice was made rather for market considerations. In another case, the background was similar. An enterprise founded in Xinjiang also moved the company headquarters to Guangzhou. The entrepreneur only held a Xinjiang *hukou*. He explained that Guangzhou was a place where information transactions were far better and the government administration was flexible and pragmatic. In this case, market forces obviously played a leading role in his decision.

The third case further backs up my argument. A returned student from the United States initially pooled his capital in his hometown in Jiangsu. But he was disappointed by his townsmen. "I started a company in my hometown… But people there, their minds are so backward. The people are pretty conservative, not open-minded, very narrow," he said in English, "People here in Guangzhou are different because it is close to Hong Kong and Shenzhen. That makes it like a foreign country. That's why I come here."[9] Rational economic considerations — i.e. the "economic action" in the Weberian sense — obviously overrode all other considerations: political, sentimental and social factors — i.e. the "substantive economy" in the Polanyian sense.

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[9] Interviewee 44.

In the first case, his identity as a Guangzhou *hukou* holder was just compatible with his rational considerations.

In addition, the geo-economic pull effect on "business migration" from rural to urban areas and from small towns to larger cities shares the same logic as that of population migration. The pull effect is more manifest in big cities like Beijing and Guangzhou where there are millions of members of the "floating" population. The control over population mobility is becoming ineffective now. It is in part caused by the growth of the private enterprises. Despite holding no local *hukou*, the "non-resident" entrepreneurs were capable of obtaining sufficient daily necessities from the market now, including solving the education problem of their children. The private enterprises also employed a lot of people who were not local *hukou* holders. For example, in one of my cases, 50% of the staff of a large education software company in Beijing, CSC, does not hold Beijing *hukou*.[10]

One thing the "non-resident" entrepreneurs grumbled about was the difficulty of applying for a passport. It is significant for the businesspeople now to go abroad for business reasons. However, to do so they needed to return to their hometowns, where their personal dossiers were kept, to apply for it. They also found it difficult to apply for passports or other warrants for their "non-resident" staff if necessary, as their enterprises are not *danwei*. On the other hand, when some entrepreneurs had a chance to obtain a local *hukou*, they declined to apply. Among my interviewees, a "non-resident" entrepreneur in Beijing was offered a chance to apply by virtue of his economic contribution. However, he did not want to go through the rigmarole of the application,

[10] See *Zhonghua gongshang shibao* [China Business Times], 26 April 1999: 5.

so he simply gave it up.[11] Indeed, the considerable number of "non-resident" entrepreneurs in this study demonstrates that the *hukou* system neither imposes constraints upon nor provides any significant benefit to the private entrepreneurs now. With hindsight, some local governments have relaxed controls over the entry of "outsiders" in order to absorb outside investment. For instance, in Guangzhou, non-resident private investors who have attained a certain level of tax contributions within a certain period of time can now apply for a transitional residency, a so-called blue seal *hukou*, for themselves and their family members and staff.[12]

"Business migration" was found not only in terms of rural-to-urban or town-to-city but also district-to-district within a city. It should be noted that small enterprises in cities are usually registered with the district's Bureau of Industry and Commerce Management (BICM). They are directly regulated by various departments of the district's government. The enterprises pay taxes and other fees to the district's government instead of to the municipal government. Hence, the regional economic competition is not only between higher-level but also between lower-level administrative regions. In Beijing, there is a fierce competition between Haidian District and Chaoyang District in luring business investment. Given the expensive office rents and poor traffic conditions in Haidian District, some private technology-based companies have now moved to Chaoyang District, where the environment is much better (it is the embassy district). The district also offers attractive preferential-policy packages aimed towards the new entrants.[13] In addition, some enterprises moved their

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[11] Interviewee 2.
[12] *Nanfang ribao* [Nanfang Daily], 21 September 1999: 1.
[13] See *Beijing jingjibao* [Beijing Economic Daily], 29 June 1999: 6 & 6 June 1999: 2.

factories out from the urban districts. One of my cases was in the midst of moving its factory from Beijing City to the outskirts county Changping, where it was offered cheaper land and other preferential treatment.[14]

This regional competition can be utilised and distorted by entrepreneurs. For instance, the official domiciles of some enterprises among my cases were not the places they were actually doing their business. Various particular reasons account for this practice, but in so doing, they pay taxes to one district's government but earn their revenue in another district. In other words, it is possible that an IT entrepreneur can register his firm and pay his enterprise's taxes in Chaoyang District where he enjoys preferential policies, but carries out his business in Haidian where it still enjoys a locational economic advantage. Entrepreneurs can maximise their profits by exploiting the structural defects of the administration system.

Political Profiles and Capital

The political profiles of my interviewees were not, in general, auspicious. Only four entrepreneurs among my cases were Party members. None of the rest claimed to have joined any other Party-endorsed political parties. Among the four Party members, only one entrepreneur claimed that he still participated in Party activities and had a Party branch in his enterprise.[15] The rest of the three were inactive members. One of them even claimed that he might withdraw from the Party.

Three entrepreneurs were the members of local People's Political Consultative Conferences (PPCCs). They were co-opted into the PPCC because of their membership

[14] Interviewee 24.
[15] Interviewee 51.

of the Federation of Industry and Commerce. One of these was Yuan Yongmin in Beijing. He was famous for his pioneering attempt to produce aircraft privately. He was an active PPCC member and concurrently the vice-chairman of the Haidian Private Enterprise Association and Haidian Federation of Industry and Commerce. He treasured these "semi-political" positions and made use of this identity to tap various economic resources. However, the other two entrepreneurs who belonged to local PPCCs seemed indifferent to their membership. One was the entrepreneur from Xinjiang, and the other was one of the Party members I mentioned in the paragraph above. His indifference was caused by cynicism toward politics after the June 4 1989 Incident. This disappointment over politics was his impetus to launching a business on his own. But he also recognised that he gained a little advantage by being a PPCC member, that no one dared bully him due to this identity.[16]

The most influential political position that private entrepreneurs can attain may well be to become a deputy to a People's Congress. The entrepreneur from Xinjiang had been a deputy to the People's Congress in Xinjiang. Two celebrities among my cases were also the deputies. One is the president of CSC Group, Song Chaodi, the other the president of Ufsoft Group, Wang Wenjing. Song was a deputy to Haidian People's Congress, and Wang had been a Standing Committee Member of Beijing's PPCC in 1993 and was elected a deputy to the National People's Congress in 1998. Obviously, he was wielding a certain degree of power to represent the interests of his industry and to influence government's policy making.

Another case that should be noted is Edward Zeng. He was a returned student from Canada, holding a passport of Canada. His company, Sparkice, formed a Sino-

[16] Interviewee 25.

foreign joint venture with China Unicom to enter the e-commerce business. In this joint venture, the foreign partner (i.e. Sparkice) held 51 percent of the company's shares. The possession of majority shares by foreign investors was prohibited in the telecommunications sector under government regulations. Obviously, he was enjoying a certain degree of privilege. His linkage with the state agents who oversaw telecommunications was conspicuous. Before he went abroad, he had been in charge of a research group of the state's Information Centre under the State Planning Commission in 1987. After his return, he became an IT policy advisor to the government and a guest researcher of several commissions and ministries.[17] There was no doubt that he had a good position to bargain for favourable conditions and in swaying the government policy.

Despite this particular case, securing political capital for these private enterprises was usually a function of political co-optation. The bigger an enterprise, the more exposed the enterprise, and the more likely that the entrepreneurs of the exposed enterprise would be co-opted by the government by offering them positions in intermediary organisations and the parliament-like PPCC and the People's Congress.

Background of the Enterprises

As of the end of the year 1999, the average length of existence of these enterprises was 4.6 years, and the median was 4 years (See Table 5.2). The oldest enterprise had operated for 13 years, founded in 1986 in Guangzhou. The youngest two enterprises were founded in September 1999. These two enterprises were registered at the

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[17] *Business Weekly*, 24 October 1999: 5.

Entrepreneurs Park in the Guangzhou Economic and Technological Development Zone (GETDZ). The Park was an enterprise incubator, mainly to absorb returned overseas Chinese students to bring back foreign technologies to China. The park had just opened when I visited it. Despite the newly founded enterprises, the entrepreneurs were not fresh hands. Both had started their own businesses respectively in 1990 and 1994.[18] The enterprises were only one of their new projects.

Table: 5.2: Length of Existence of the Enterprises (N=50)

Years	<1	1 - 3	4 – 6	7 - 8	9 – 10	> 10
No. of Enterprises	5	15	19	7	1	3

Ownership and Ownership Transformation

Not all of the enterprises were founded or owned by the entrepreneurs themselves. There were five such cases. The first case was a software company funded by a foreign venture capitalist. After poor performance by the first CEO, the incumbent CEO, who had originally been a deputy general manager of the company, replaced him. The second case is the state-funded *minying* software company mentioned above. The third case was originally a small SOE in charge of the greening of GETDZ. In the wake of poor performance, it was auctioned off in 1998, and is now owned by the former peasant I mentioned above. The fourth case is an Internet service company that was founded by an entrepreneur who is one of my interviewees but was funded by another private capitalist. The last case is a software company that was founded by a computer

[18] Interviewees 44 and 45. One is the returned student with his origin from Jiangsu I mentioned.

engineer in 1994, but in 1998 was taken over by another private businessman who is among my interviewees.

Among the remaining 45 cases, 13 claimed that the enterprises were exclusively owned by the entrepreneurs themselves from the very beginning. Four of these have absorbed new shareholders. But two that originally were partnerships were now claimed to have been transformed into sole proprietorships. As a result, plus the two cases of sole proprietorship in the last paragraph, there were now 13 cases of sole proprietorship (26%) (see Table 5.4). By and large, the sole proprietorships did not prevail among my cases, though this impression will be slightly qualified when I explain the shareholding components of the enterprises later.

The above was only the *de facto* ownership that the entrepreneurs claimed. The *de jure* ownership reflected by the enterprises' registrations produced a different and more complicated story (see Table 5.3 and 5.4). First of all, among the "alleged" sole proprietorships eight cases were registered as collectives and five were registered as limited companies from the very beginning. Another case was registered as a foreign-invested company, but was actually owned by an indigenous entrepreneur who asked an overseas Chinese friend to register a company for him.[19] It is a so-called private company wearing a "foreign" hat (*dai yang maozi*). The four remaining foreign-funded companies really did possess foreign investment, but the foreign partners or investors in three cases were returned Chinese students. Only one case was fully funded by a foreign venture capitalist.

[19] His friend remained the legal-person representative of the enterprise when I interviewed him.

Table 5.3: The Contrast between Alleged Ownership and Registered Ownership during the Establishment of Enterprises (N=48)*

	Alleged Ownership				
Enterprise Registration	Sole Proprietorship	Natural-person Partnership	Legal-person/ Legal-Natural Person Partnership	Shareholding Cooperative	Total
Getihu and Unincorporated Enterprise		5			5
Collective	8	2			10
Limited Liability	5	21	2		28
Foreign#	1		2		3
Sino-foreign#			2		2
Total	14	28	6		48

* The two SOEs are expunged from this analysis.
\# Foreign and Sino-foreign Enterprises have to be limited liability companies.

Table 5.4: The Contrast between Alleged Ownership and Registered Ownership during the Period of Interviews (N=49)*

	Alleged Ownership				
Enterprise Registration	Sole Proprietorship	Natural-person Partnership	Legal-person/ Legal-Natural Person Partnership	Shareholding Cooperative	Total
Getihu and Unincorporated Enterprise					
Collective	4			1	5
Limited Liability	8	23	5	1	37
Foreign#	1		2		3
Sino-foreign#			4		4
Total	13	23	11	2	49

* One of the SOEs was now privatised, so the total enterprise number increases to 49.
\# Foreign and Sino-foreign Enterprises have to be limited liability companies.

Those enterprises of sole proprietorship, but falsely registered as collective, were, except for one, established before the adoption of the 1994 Company Law. It was a usual practice for businesspeople at that time to put on a "red hat" if they wanted to set up a "*gongsi*" (company) all the while *de facto* retaining sole proprietorship. As for the exceptional case, the owner formed a "collective" firm with his friends in 1989, but the partnership dissolved in 1996, and then he set up a new "*gongsi*" alone in 1997 and kept registering it as "collective." When I asked him why he did not register it as a limited company, he replied, "there is no need to change for the time being. If it does need a change, it would became a limited company then."[20]

Many enterprises that have *de facto* sole proprietorship have registered themselves as limited companies. Different from the registration of collective enterprises, they need to invite a "symbolic" partner, usually siblings, wife or close friends, to jointly register the companies, because the company registration regulations before 1994 and the Company Law both stipulate that the minimum shareholders for forming a limited company are two. Yet the "symbolic" partner does not need to pool his/her capital. S/he also holds no executive position in the company. Of course, the registered shares of this partner are minimised, usually amounting to around 10-20% in my cases. According to the interpretation of a jurist in China, when the establishment of limited companies requires at least two shareholders, it does not follow that the company would dissolve if one of the two shareholders withdraws his/her investment from the company.[21] In other words, sole proprietorship in a limited company is lawful. However, no one in my cases had attempted to withdraw the symbolic partner.

This distorting behaviour of forming phoney partnership enterprises should be attributed in part to the constraints imposed by the corporate regulations and laws in China. These regulations and laws discourage the growth of sole proprietorships in a number of business fields. For one thing, there were many industries in which only

[20] Interviewee 27.

[21] See Wang Baoshu & Cui Qinzhi, *Zhongguo gongshifa yuanli* [Principles of China's Company Law] (Beijing: Shehui kexue wanxian chubanshe, 1998), 134.

legal-person enterprises were entitled to run businesses. But a wholly individually-owned enterprise usually holds no separate legal personality. For another, legal-person enterprises usually refer to the company carrying the word *gongsi* [i.e. company or corporation] in their names, and by the same token, all wholly individually-owned enterprises are not entitled to carry "*gongsi*" in their names. Now only collective and state-owned enterprises and limited companies (all foreign-funded enterprises must be limited companies) are allowed to be "*gongsi*." *Gongsi* in Chinese symbolises a higher status for a business concern and it sounds better for an entrepreneur to make various business deals with this name. Wholly individually owned enterprises and partnership enterprises with unlimited liability are sometimes confused with *getihu* in image — and how can another company of considerable stature be expected to negotiate a big project with a *getihu*?

Five of the enterprises in my cases were founded as *getihu* or as unincorporated private enterprises, i.e. wholly individually-owned enterprises and partnership enterprises. The latter slightly differed from *getihu* in the sense that these two types of enterprises should employ more than seven persons in principle and usually needed to have a fixed place of production and business, and their products were not necessarily consumption goods, whereas *getihu* usually refers to such small retailers as peddlers. However, the difference is not so distinct in practice. As I discovered, many of the private enterprises (*siying qiye*) actually employ less than eight persons.

Among these five cases, only two entrepreneurs clearly stated that their companies had developed from *getihu* firms. One of them was the Ufsoft Group.

However, its business from the outset had a fixed office.[22] As for the other three cases, the interviewees could not clarify whether they were *getihu* at the beginning, but certainly they started from an unincorporated enterprise. Those engaged in retailing businesses usually carried the word *jingyingbu* in their concerns' title, literally meaning "sales department," somewhat like "outlets" in operation. Those providing technical services might carry the word *shiwusuo* or *fuwushe* (service or consultant agent) in their title. Some collective concerns among my cases had the same practice. One of my cases, which embarked upon the software engineering, had been named *gongchengbu* (engineering department) initially.[23]

In a nutshell, these five were not "companies," and the problem of the "title" constrained their business. The flexibility of their business operations was highly limited. The 1997 Partnership Enterprises Law and the newly adopted Wholly Individually-owned Enterprises Law have not lifted this restriction. Some entrepreneurs in Anhui expressed complaints to a reporter before the promulgation of the Wholly Individually-owned Law, saying, "the nature of enterprises should be divided according to different liabilities, [but the nature of an enterprise] should have nothing to do with the use of the concern's title. Not allowing a wholly individually-owned enterprise to use '*gongsi*' in its title does not accord with the demands of current economic development … State-owned enterprises, collective enterprises, and joint-stock enterprises and foreign-funded enterprises also have different forms of investment, but they all can use '*gongsi*,' and only the wholly individually-owned enterprise can't. It is not understandable. … Many foreign-funded enterprises are formed by [one] natural

[22] *Beijing jingjibao* [Beijing Economic Daily], 18 April 1999: 5.
[23] Interviewee 35.

person. Why can they bear limited liability and use "*gongsi*" as a title whereas the wholly individually-owned enterprise must bear unlimited liability and can't carry '*gongsi*'."[24]

Nevertheless, the five cases did not all start from sole proprietorships. Once the enterprises enlarged to a certain scale, they should have been qualified to re-register themselves as statutory companies. However, two of them became sole proprietorships as the partnership dissolved. Yet they formed limited companies at last. The other three cases were also transformed into limited companies while keeping the partnership intact. Comparing Tables 5.3 and 5.4, it can be seen that the overall trend of corporate transformation in my cases was towards limited companies, including foreign and Sino-foreign limited companies. The enterprises that started as limited companies comprised only 33 cases, but after the transformation, the total number of limited companies rose to 44 (88%).

After the implementation of the Company Law in 1994, "incorporation" (*gongsihua*) becomes the sole direction of development for most enterprises. I asked one of the interviewed entrepreneurs, who formed a limited company with a "symbolic" partner in Guangzhou, why he did not form a wholly individually-owned enterprise. He replied, "it is not allowed to set up one-man-owned ***company*** (*duzi gongsi*), ... so many of my friends in the computer industry registered their companies like mine."[25] Obviously the major consideration lies not in liability but whether it is a "company."

Incorporation was sought not only by the unincorporated private enterprises but also by the "fake" collective enterprises. Different from the former, the "fake"

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[24] *Zhonghua gongshang shibao* [China Business Times], 7 August 1999: 2.
[25] Interviewee 37.

collective enterprises aimed at "taking off their red hats" by incorporation. Of the 10 cases of originally collective enterprises, five of them have been transformed into limited companies. Even though collective enterprises can carry the name "*gongsi*," their property rights structure does not accord with the "modern company system" required by the Company Law. This is not simply a problem of having a legitimate legally-binding status but rather a rational business consideration for them to transform their enterprises into limited companies. One of these cases was re-registered as a limited company in 1998. The reason for the transformation was mainly to absorb new financing. Originally, the enterprise had been owned by one person. In order to absorb three external investments, it had to have a clear property rights structure. The entrepreneur also pointed out that to enlarge the scale of a collective enterprise needed the approval of its leading authority (*shangji bumen*). However, his firm had no leading authority at all, albeit it had been attached to another company (*guakao gongsi*).[26]

Two cases were transformed into Sino-foreign enterprises. The original collective enterprise, taking the form of a legal entity, formed a joint venture with the foreign partner. This method of transforming the original collective enterprise into a legal entity is also applied to long-established large-scale collective enterprises. Since it is difficult to clarify the property rights among the founders of the enterprises after a long period of development, they needed to keep the firms from becoming further complicated in terms of property rights. It would have become too difficult to settle disputes caused by conflicts of interest between the founders, and if this were to happen, the development of the company would be seriously retarded. Stone Group is a typical

[26] Interviewee 2.

example.[27] In this study, there is a similar case, the Suntek Group. It is the oldest company among my cases, founded in 1986. It started with 12 persons who mostly had been faculty members of renowned Zhongshan University in Guangzhou. The enterprise registered itself as a collective in the name of the "Guangzhou New Technology Research and Design Institute." At that time, the concept of "company" had not yet been introduced. But with the expansion of its businesses and subsidiaries, it was transformed into the Suntek Group in 1994. But the Guangzhou New Technology Research and Design Institute was kept intact, becoming the holding enterprise of the Suntek Group.

For small collective enterprises, if they do not absorb new finance and partners, to become a shareholding cooperative is a possible direction of development. Here, the shareholding cooperative is little varied from the official concept. The official shareholding cooperative (*gufenhezuo*) is a combination of public and private ownership. The pertinent cases here, though, refer to private business owners issuing a small amount of shares to their senior staff without any *quid pro quo*. Table 5.4 contains two shareholding cooperative enterprises. In one of the two cases, shares were issued but the firm did not remove its "red hat" by re-registration. The other case was transformed into a limited company after this arrangement. Legally speaking, this re-registered enterprise should be a limited company of natural-person partnership, but in this case, the new partners had not put any new capital into the company and the staff

[27] Stone Group was a renowned private computer company in the 1980s, but it was registered as a collective. In 1988, it was one of pilot enterprises assigned to carry out a shareholding reform. However, it was implicated in the June 4 Incident and then personnel conflict among top executives ensued so that the property rights of the company had not been clearly defined until the end of the 1990s. Many people took the unsettled property rights problem as an account of the slow development of the company in the 1990s.

shares had not significantly redistributed the authority between the primary owners and the staff. This is somewhat like the pattern of shareholding cooperatives that had originated from the rural township enterprises.[28] The shares of the enterprise are just internally redistributed. The function of this is to give the staff greater material incentives. To be sure, we should not understate the significance of this practice. In order to retain the high calibre of the services of technicians and managers, many business owners in the IT industry consider giving a small portion of shares to their senior staff.

Another trend of transformation that I touched upon above was the growth of legal-person partnerships. Comparing Tables 5.3 and 5.4, it should be noted that the total number of natural-person partnerships was reduced from 28 to 23, albeit the limited companies of natural-person partnership increased from 21 to 23. By contrast, the legal-person or legal-natural person partnerships increased from 6 to 11. This is the sole category of ownership, except for the shareholding cooperative, which shows a net increase. This reflects the fact that some of my cases have been experiencing a more advanced and complex ownership transformation. The entrepreneurs were engaging in various formats of investment, including amalgamation, acquisition and fragmentation,[29] on behalf not of themselves but their legal-person entities, an investor-

[28] For studies on the rural shareholding co-operatives, see Jenny Clegg, "Multi-stakeholder Cooperation in China — Changing Ownership and Management of Rural Enterprises," in Flemming Christiansen & Junguo Zhang (eds.), *Village Inc: Chinese Rural Society in the 1990s*. (Richmond, UK: Curzon, 1998); Eduard B. Vermeer, "Shareholding Cooperatives: A Property Rights Analysis," in Andrew G. Walder & Jean C. Oi (eds.), *Property Rights and Economic Reform in China* (Stanford: Stanford University Press, 1999); Susan H. Whiting, "The Regional Evolution of Ownership Forms: Shareholding Cooperatives and Rural Industry in Shanghai and Wenzhou," in Andrew G. Walder & Jean C. Oi (eds.), *Property Rights and Economic Reform in China* (Stanford: Stanford University Press, 1999).

[29] Fragmentation refers to splitting up various businesses of an enterprise into several independent entities.

friendly tool. The emergence of "legal-person organisations" has a special connotation in the context of socialist China. It helps to de-personalise the private property of entrepreneurs in order to make the private enterprises conform to the notion of socialism. Many of the entrepreneurs whom I interviewed stressed that they had not drawn a "dollar" from the companies, and that they pooled all profits into reinvestment. When I asked an entrepreneur his opinion as to whether the state sufficiently protects private property, he nervously insisted, "I have no private property, the property is the company's."[30] This reflects a residual fear of socialist thought, but also reflects a positive function of the "legal person" nomenclature.

The legal-person partnership also facilitates the development of various types of mixed enterprises, i.e. *minying* enterprises. One of my cases is a joint venture between a private enterprise and a SOE.[31] Another interviewee in Beijing similarly claimed that he was negotiating a joint operation or joint venture with a large-scale state-owned steel group in Beijing.[32] On the other hand, some state capital is also de-statised in the sense that the incorporated state enterprise also holds a separate legal personality. This more or less helps the state-owned company to absorb non-state capital and to enter into contracts and form joint ventures with a private enterprise.[33] As noted in Chapter 3, the boundary between the state and the private enterprises is beginning to become blurred.

The main group among my cases is the enterprises of natural-person partnership. These partnerships stem mainly from within peer groups such as friends, colleagues and

[30] Interviewee 24.
[31] Interviewee 25.
[32] Interviewee 2.
[33] Of course, it also facilitates corrupt state officials to siphon off state assets by forming joint ventures with private capitalists. See Chapter 3, fn. 68.

purely business-oriented impersonal relationships. Out of the 23 natural-person partnerships, only three cases were not of this type. One is a family-member partnership that is not in the IT industry. The firm is a sales agent for food and beverage companies. Another is a husband-wife partnership. The last is a partnership with a brother-in-law. The dominance of peer group partnerships is self-evident in the IT industry, because the industry is a synergy of knowledge rather than of manual labour. IT-related knowledge is usually shared by peers rather than family members of different generations. As noted above, the social networking of these well-educated entrepreneurs is more open than among other groups of people, especially compared with less-educated rural entrepreneurs. This has resulted in a higher probability of forming this type of partnership. Last but not least, in many cases only a peer-group partnership could raise sufficient capital to open a company, as the capital requirements for running certain businesses are quite high.

Capital Registration and Business Categories

The previous section indicated that most of these entrepreneurs inherited nothing from their families, and that these entrepreneurs started almost from scratch in terms of capital. The savings from employment and small business trading were major sources of capital for common would-be entrepreneurs. For would-be IT entrepreneurs who themselves received a training in computing, casual jobs in programming were also a source of raising funding. It is a "hot" job among young IT people in Haidian District.

However, in terms of the IT industry, the key capital for setting up a business does not rest on money but human capital. Song Chaodi, the president of the CSC Group, claimed that he started the CSC with merely 600 yuan in 1991. Yet a question should occur to us. If they registered their firm as companies, they needed to possess a considerable amount of capital. Where did they draw the money? The answer is that they overstate their registered capital. This so-called "overstating" refers to two methods of fabricating registered capital. One is to temporarily borrow money from kith and kin to meet the basic requirements for forming a company. No sooner is the company registered than the money is withdrawn from the officially designated account and returned to the lenders. Another practice is to employ an auditing agent to issue a false financial statement to the BICM. By this method, one might pay several thousand yuan to the agents in order to set up a company which on paper possesses capital and assets worth hundreds of thousands of yuan. But this practice was suppressed recently. In this study, 14 interviewees confessed to having overstated their registered capital by one of these two methods at the time of initial registration. Many of them defended this as a usual practice among businesspeople. An interviewee observed that in China, "if you register a company as having a million yuan, it is not bad if it really has a hundred thousand yuan."[34]

One may ask how their businesses operate without sufficient financing. The fabrication of registered capital possesses a similar logic to the fabrication of a partnership, as has been discussed above. It is more or less attributed to the unreasonable limitations imposed by the corporate regulations and laws. Since the introduction of the category of a "limited company" at the end of the 1980s, the entry barriers to setting up a company have been very high. Various minimum amounts of capital have been stipulated for different industries to establish a limited company. According to the enterprise registration regulations promulgated in 1988, the legal-

[34] Interviewee 19.

person enterprises embarking upon consultant and service business had to have at least 100,000 yuan; those embarking upon manufacturing and retailing had to have at least 300,000 yuan; those embarking upon wholesale of merchandise had to have at least 500,000 yuan. Other legal-person enterprises needed at least 30,000 yuan as their minimum registered capital.[35] These limitations were basically transplanted into the provisions about the establishment of limited companies under the Company Law. But the minimum capital requirement for manufacturing businesses rose to 500,000 yuan under the Company Law. The above only notes the general capital requirements for establishing a company. There is a separate specific administrative rule governing the capital requirements for individual industries. For example, a company engaged in advertising services required at least one million yuan in registered capital.[36] Obviously, it was difficult for the populace, especially in the 1980s and the early 1990s, to set up their own companies.

Many businesses *per se* actually did not need such a large amount of investment. Hence, the behaviour of overstating registered capital was considered justifiable by the entrepreneurs. And this is especially true for the IT industry, apparently for the software sector. As its production process involves intellectual inputs rather than massed manual labour and capital inputs, it is unreasonable to require hundreds of thousands of yuan of capital. However, being classified as a manufacturing industry, software companies are normally required to have 500,000 yuan in registered capital. There were seven cases among the software companies that started with 500,000 yuan in initial registered

[35] See Gao Qiao (ed.), *Zuixin qiye jingying falü fagui shiwu zhinan* [Directory of New Laws and Regulations on Enterprise Operation] (Beijing: Qiye guanli chubanshe, 1994), 153.
[36] Interviewee 3.

capital. Three of them overstated their registered capital, while the rest relied upon temporary loans to meet the requirement. At the same time, some of the other software companies could be registered with less than 500,000 yuan. These business owners usually registered their enterprises as consultant and service companies, for which the minimum requirement was 100,000 yuan. This variation reflected the strategic wisdom of businesspeople on one hand, and the discretion of officials of the BICM in classifying the companies on the other.

Nevertheless, we should not overlook that some of my cases started as unincorporated enterprises or as small collective enterprises that did not require such a high minimum registered capital. Accumulation of capital from initial business profits helped them to attain the minimum requirement for forming a company later. In addition, a few enterprises were not the first investment projects of the owners. As they had completed capital accumulation already, their entry into the new project usually had sufficient financial backup, sometimes even more than the official requirements. Those initiated by legal-person investment, especially by foreign-funded firms, usually had better finances.

With China's economic development plus inflation, the gap between the official stipulation and the real capital requirements for business operations has been narrowing. According to CASS's survey, the average initial capital showed conspicuous growth between the enterprises founded during the 1978-1991 era and the post-1991 era. The former was 323,000 yuan; the latter was 508,000 yuan.[37] In my research into the IT industry, it was also found that the *de facto* capital demands increased because of more

[37] Zhang Houyi & Ming Zhili, (1999) op. cit., 134-5.

competition in the industry. Capital resources become a growing factor for an enterprise to compete for the edge in the market. When aggressive companies intended to seize more market share in a short time, a huge capital investment became a vehicle.

In general, though, the registered capital does not genuinely reflect the assets of an enterprise — not necessarily always the case of exaggeration, but also sometimes of understating. In some cases, the first capital registration was simply aimed to meet the requirement procedurally, and the actual capital input might be much larger than the registered capital. For example, the peasant in Guangzhou spent 830,000 yuan to buy out the SOE, while the company was registered with only 500,000 yuan in capital.[38] With the passage of time, many companies grew much larger than the amount of assets they claimed in their registration, but they seldom increased the registered capital right away, because each re-registration involved complicated procedures.

However, when they took up bigger business projects, they had to have the registered capital augmented, because of concerns about the liability of the company. Hence, increasing the registered capital to a certain extent reflected whether an enterprise has gone beyond the germinal stage of development. 21 enterprises had increased their registered capital since their founding, while another 26 enterprises remained at the germinal stage of development. It should not be judged that the performance of these 26 enterprises was undesirable, since the length of operations of the enterprises needs to be considered. In Table 5.5, only 8 firms that started during the period from 1991 to 1995 never had their capital re-registered. The other 15 firms that

[38] Interviewee 39.

were established during that period had already changed their registered capital since their founding.

Table 5.5: The Adjustment of Registered Capital among the Enterprises (N=47)

Founding Year	Pre-1990	1991-2	1992-3	1994-5	1996-7	1998-9	Total
Registered Capital Increased	3	5	5	5	2	1	21
No Registered Capital Increased		1	3	4	7	11*	26

* One of the enterprises was founded in 1994, but it was taken over by the interviewed entrepreneur in 1998. Hence, I took it from 1998.

The type of activities an enterprise engages in also provides a backdrop that sheds light on these cases. In 43 cases, the enterprises were involved in varying degrees of technological exploitation. I term these as technology-based enterprises. However, they were not all in the IT sector. Two of them were in the pharmaceutical industry. Another was engaged in the manufacturing of light aircraft. The last specialised in research and development (R&D) to produce LCD projectors.

Out of the 42 cases from the IT industry, three of the firms were not technology-based enterprises but engaged in merchandising computer hardware. Even though one of them launched a web-based trading business, it was only the user of new technology. The remaining four cases embarked upon non-technology-related businesses. These were an advertising production company, a sales agent for food and beverage companies, a land property company and an agricultural technology company.

20 cases were registered in a "special economic zone," enjoying various degrees of preferential policies. The zone in Beijing was the Experimental Zone for New Technology Industry, and in Guangzhou the Tianhe Scientech Park and the GETDZ.

The IT enterprises could be divided into six broad categories: PC production, merchandising, software development/retailing, system integration, Internet-related service, and telecommunications. Some of my cases overlapped more than one category. Some had started in hardware trading but completely or partly switched to software engineering. In addition, telecommunications, system integration and Internet-related technologies involve techniques of software engineering. In terms of their core business, however, I have tried to put the 42 IT enterprises into the six categories shown in the following table.

Table 5.6: Categories of IT Enterprises

Categories	PC Production	Merchandising	Software	Internet	System Integration	Telecom.
Number	2	4	26	6	2	2

The software firms constituted 62% of all the IT enterprises, and they can be further sub-grouped according to their major speciality. These included education software (4 cases), offshore services (2 cases), games (2 cases), finance software (3 cases), management software (7 cases), computer-aided design/computer-aided manufacturing (CAD/CAM) (2 cases), encryption (2 cases) and Chinese character input (1 case). The remaining three firms had no speciality. In addition, two of the software companies were concurrently engaged in software retailing businesses.

Unlike manufacturing industries, most of these IT companies, except in PC production, do not demand manual labour for production. Also, they usually have no factories but only have offices for both R&D and production. All mass production processes, like software copying to CD-ROM, are contracted out to specialised factories. For the more professional software, like the management software, the purchasers are usually corporate users not individuals and hence, some companies are not concerned with any mass production. Such cases are also found among the Internet service, system integration and telecommunications enterprises. The IT industry thus is more a service sector than an industrial sector, and especially so the Internet service sector. But it is different from the general service sector, which either helps in maintaining or repairing merchandises or provides non-merchandise service, whereas the IT industry usually involves the production of both merchandise and services.

Scale of the Enterprises

Most of my cases were not large-scale enterprises. In terms of numbers of employees, 29 employed fewer than 50 persons, 10 had 50-100 employees, and only 11 had more than 100 employees. The enterprises with more than 100 employees should be considered a large company with regard to the IT industry.

The largest is a Guangzhou-based telecommunications conglomerate, Suntek Group. It employs more than 1,700 people and has 20-odd subsidiaries. Its annual turnover reached about 1 billion yuan in 1998. The second largest is the Beijing-based CSC Group, employing over 1,000 persons. The CSC is the largest education software producer in China with registered capital of 50 million yuan, possessing gross assets valued at 420 million yuan in 1998.[39] It was ranked as the 74th largest private enterprise for the year 1998 by the All China Federation of Industry and Commerce.[40] The third largest is the Beijing-based Ufsoft Group, specialising in financial and enterprise management software, with over 800 employees. The Ufsoft Group is one of the largest

[39] *Zhongguo qiyejia* [China Entrepreneur], 169 (May, 1999): 16, 20.
[40] Zhang Houyi & Ming Zhili (2000), op. cit., 113.

companies in this speciality. The sales volume of its software packages ranked the first among all domestic software products in 1999, reaching 45.6 million yuan.[41] These three enterprises were the "super-stars" among my cases.

Among the other 8 large enterprises, two had already formed a company group (*jituan gongsi*). One is a telecommunications company, similar to Suntek. It was the company, noted above, that moved its headquarters from Changsha to Guangzhou. It employs around 300 persons and has subsidiaries in Hunan Province and Shenzhen. The company's registered capital has reached 5 million yuan.[42] Another is a renowned PC manufacturer in Guangdong Province, employing around 500 persons, with its own assembly line in a suburban area of Guangzhou. The company's registered capital was 20 million yuan.[43]

A dealer of computer hardware in Beijing also has a considerable scale. It employs 200-odd persons and has branch companies in 12 major cities in China. Its core business is as a sales agent for products of the Legend Group, the top IT company in China. Its annual turnover reached 500 million yuan and it possessed gross assets valued at 20 million yuan.[44] Sparkice is another company employing 200-odd person. Edward Zeng, noted above, was the CEO of the joint venture. In 1996, he pioneered opening the first Internet café in Beijing and now has 11 Internet cafés in Beijing and Tianjin. The cafés were not an end in itself but a means for entering e-commerce. He wanted to build his cafés into a chain of e-commerce "portals." The amount of capital

[41] *Beijing wanbao* [Beijing Evening News], 6 March 2000 & *Beijing ribao* [Beijing Daily], 17 February 2000 (Internet edition: www.jb.com.cn).
[42] Interviewee 30.
[43] Interviewee 41.
[44] Interviewee 6.

and assets of the company were not available to me, but it is a partner of China Unicom, the second largest state-owned telecommunications company.

Another firm in Beijing specialises in financial software, employing 200-odd person and setting up 16 branches in China. Interestingly, the company's registered capital was only 300,000 yuan. But the general manager looked very self-confident when I interviewed him and claimed that his company was already a medium-sized enterprise and had attained an annual turnover of 20 million yuan.[45] Another, in Guangzhou, has embarked upon CAD software development. CAD is software requiring a high standard of technology and the company is an officially licensed high-tech enterprise.[46] This was the sole company, except for the state-funded one, engaged in such software development. Its registered capital reached one million yuan and it employed 100-odd people.[47]

The remaining two companies were not in the IT sector. One was a Sino-foreign joint venture, embarking upon pharmaceutical production in Beijing. But the so-called joint venture was a partnership between two brothers, one from Beijing, the other from Canada. As it had an assembly line in Beijing, it employed around 180 persons of whom 100 were factory workers.[48] The last was a land property enterprise, employing 200 persons. This was a legal-person partnership between a private company and an SOE. Its major project was re-development of an old urban district in Beijing. After the re-development, it established several subsidiaries embarking upon various businesses,

[45] Interviewee 13.

[46] The enterprises registered in the special economic zones are not necessarily the high-tech enterprises, even though they are enjoying preferential policies.

[47] Interviewee 49.

[48] Interviewee 24.

including real estate, restaurants and a hotel in the redeveloped district. Hence, the employees on the company's payroll were relatively numerous.

To be sure, the strength of a company may not be in proportion to the size of its workforce. The agricultural technology company owned by the peasant employed over 80 workers, but the company's finances were feeble and the entrepreneur operated it in debt. By contrast, an Internet service company, which employed only 20-odd people, secured 3 million yuan of investment from its investor.[49] Again, another Internet service company, with 16 personnel, obtained an injection of over one million yuan of investment.[50] Overall, the remaining 9 companies with 50-100 employees had already laid relatively sound foundations. Except for the state-funded software company, all were established before 1996, and except for one, the registered capital of all these companies reached 3 million yuan or above. The exceptional case was registered with 500,000 yuan in capital. The owner stressed that the capital strength of his company was far beyond that, but it was too complicated to re-register the company's capital. And he claimed that the company's annual turnover reached 16 million yuan.[51]

The Decline of Guakao

It is well known that many private enterprises used to attach (*guakao*) themselves to *danwei* to legitimate their status. However, this attachment usually turned the private enterprises into subsidiary concerns under the *danwei* that caused many disputes over the property rights. The practice of *guakao* more or less influenced the corporate structure of the private enterprises. Among my cases, the practice of *guakao*

[49] Interviewee 42.
[50] Interviewee 28.
[51] Interviewee 31.

was not very prevalent. Only eight firms reported having their enterprises attached to *danwei* (the *danwei* being attached to is known as the *guakao danwei*). We should dissociate the motivation behind the practice of *guakao* from the establishment of "fake" collective enterprises. While the "fake" collective was mainly to disguise the "private" nature of the enterprise,[52] *guakao* did not do so but simply made it more convenient for the enterprises to deal with various state administrative agents, which still stuck to the concept that a sponsor *danwei* should oversee all administrative procedures.

Despite this, the phenomenon of *guakao* usually took place among the companies that had started operations before the mid-1990s. At that time, government control over the growth of the private economy remained very strict. This was more pertinent in the case of Beijing than Guangzhou. Before 1993, it was stipulated in Beijing that all registered enterprises had to have a *guakao danwei*, no matter what type an enterprise it was. On the other hand, the confidence of private businesspeople in the political legitimacy of their enterprises was low. Hence, besides registering themselves as collectives, these "private" enterprises tended to look for companies or state agents to attach to. However, not all of them did so. Those which had not were so-called *wuzhuguan jiti* [collectives without supervising units]. There were two such enterprises among my cases. To be sure, some collective enterprises with *guakao danwei* were no different from the collectives without supervising units, because the *guakao* was sometimes "nominal," just for meeting the rules of registration. In a case noted earlier,

[52] To register an enterprise as a collective also previously helped to secure some preferential policies.

the entrepreneur even forgot what *guakao danwei* his company was supposed to be attached to.[53]

A limited company among my cases from Guangzhou was founded in 1993 and attached itself to a high-tech SOE, but the aim of the attachment was to share in the preferential policy of tax exemption enjoyed by the SOE.[54] The privatised agricultural technology company also remained nominally attached to its original parent company, but the owner stressed that his company had become an independent entity. Another limited company, founded in 1997, also had a "nominal" attached *danwei*. The entrepreneur noted that he had not been confident enough to open an entirely private enterprise at that time.[55] This was an isolated case in this study. Most of my interviewees had founded their companies after the mid-1990s and thought that the practice of *guakao* was obsolete.

Among the enterprises with *guakao danwei*, two had detached from it by re-registering themselves as independent companies. The interviewee in another case revealed to me that the government now required all enterprises to better define their property rights, which implied incorporation. He said to me with confidence that his leading authority was very liberal, and therefore guaranteed that all of the assets his company had earned would be owned by him.[56] Obviously, the function of *guakao* is dwindling to nothing. To enjoy preferential policies is no longer the privilege of collective enterprises and SOEs. Despite the decline of *guakao*, though, some private entrepreneurs feel that they need an attachment to a leading authority. The Chinese

[53] Interviewee 2.
[54] Interviewee 34.
[55] Interviewee 37.
[56] Interviewee 7.

danwei system is still moulding the relationship among individuals, organisations and the state, even though the *danwei* system is disintegrating.[57] Unorganised individuals and organisations without any attachment to a sponsor have tended to be isolated from formal institutions. As noted earlier, as a private enterprise was not regarded as a *danwei*, this caused a certain degree of inconvenience to business operations. Of course, the private entrepreneurs would not like to be subjected to the traditional control of a *danwei* again. They would like to have official assistance to facilitate their business operations. The enterprises that are registered in the "special economic zones" seem better able to enjoy such services from the government. This issue will be further discussed in Chapter 7.

The Macro-Structures of Enterprises

With the decline of *guakao*, my cases in general become autonomous economic entities. But their structure is not necessarily simple. Many private enterprises have already developed into a complex group of entities. This has been revealed in my cases' ownership structure, presented in the last section. Here I will present how the shape of its ownership forms the macro-structure of an enterprise. Since each case has its own particular ownership structure, it is difficult to detail each case, especially in the cases of conglomerates. But here I will try to single out several distinct features of these enterprises and to reduce them to several major models (See Figure 5.1).

In general, the enterprises can be placed into two broad categories with four branches of concrete models. The two categories are (i) unitary and (ii) amalgamated.

[57] Ji You, *China's Enterprise Reform: Changing State/Society Relations After Mao* (London: Routledge, 1998).

The unitary pattern refers to a company wholly owned by one investment entity. The investment entity may be either natural persons or one legal person. If the investment entity only owned one company, the enterprise belongs to a "single" model. The "single" model is also sub-divided into enterprises with or without legal-person status, i.e. either a natural-person enterprise or a legal-person enterprise. If the enterprise makes use of its legal-person status to open subsidiaries, which also have a separate legal-person status, the enterprise is of a "detachable grouping" model. The "detachable" denotes that the parent company and its subsidiaries are two separate legal-person entities, even though the parent company is the holding company. It is a usual practice that an enterprise tends to separate the new business from the old by setting up another legal-personal entity. Then in case the new business fails, it would not financially or legally implicate the parent company.

The amalgamated pattern refers to the forming of a joint venture by more than one investment entity. This pattern has two models. One is the model of a "detached" joint venture. Two or over two separate legal-person entities, sometimes joined by natural persons, respectively pool capital to form a new independent legal-person company. The parent companies themselves bear no liabilities vis-à-vis the new company, as in the case of a "detachable grouping." Another model is the "absorbed" joint venture.[58] One legal-person entity absorbs investment from another legal-person entity, transforming itself into a joint venture. In this case, only the external investment entity bears no liabilities for the joint venture.

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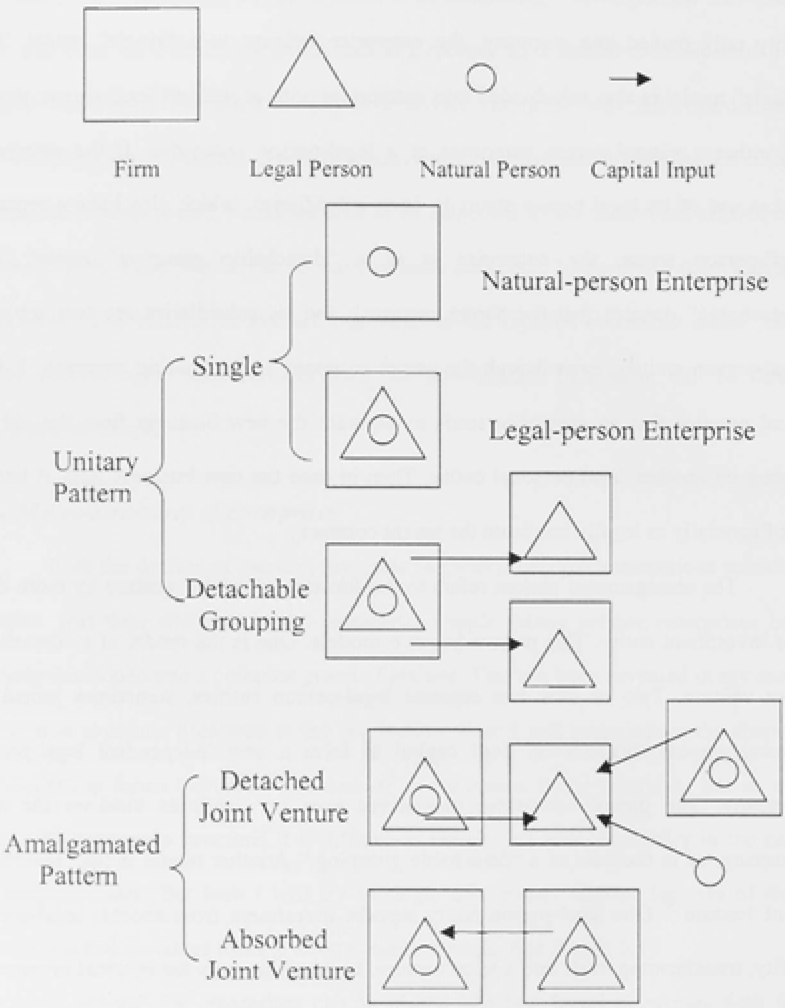
[58] If it absorbs the investment from natural persons, it is not a joint venture and should fit the "single" model.

Figure 5.1: Models of Enterprise Structure



The four structures are only ideal types. In practice, some large-scale companies with subsidiaries tend to comprise a compound model mixing the "detachable grouping" and "detached" joint venture together. The CSC Group and the Suntek Group are of this kind. Most of the cases fit a single model: 29 cases fit that of a single legal-person company and 5 cases fit that of a single natural-person company. Five cases fit the "detachable grouping" model; another 6 cases fit the model of a "detached" joint venture and the remaining 3 cases are "absorbed" joint ventures.

Is Entrepreneurial Familism Significant?

This study does not focus upon the internal business management, but it is noteworthy that the family firms do not prevail among my cases, while many other studies of Chinese enterprises stress the cultural prevalence of family enterprises in Chinese business communities.[59]

It appears that the cultural interpretation is not applicable to the IT sector. As noted above, the well-educated background of these entrepreneurs plus their shared knowledge of the IT industry resulted in a higher probability that they form a peer group partnership rather than a family company. Another factor should not be left out — many of these entrepreneurs were not native. Even if they possess a local *hukou*, their relatives do not. Hence, a family enterprise became impossible. Moreover, these entrepreneurs have voluntarily preferred to take the risk of launching their businesses outside their mother towns. I suspect this phenomenon is also shared by other types of private enterprises in cities, as social ties articulated outside *danwei* and kinship become increasingly significant among new generations in urban areas.[60]

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[59] Gordon Redding S., *The Spirit of Chinese Capitalism* (New York: W. de Gruyter, 1990); Siu-lun Wong, "Chinese Entrepreneurship and Economic Development," in Barett L. McCormick & Jonathan Unger (eds.), *China after Socialism: in the Footsteps of Eastern Europe or East Asia?* (Armonk: M.E. Sharpe, 1996); Farid Harianto, "Business Linkages and Chinese Entrepreneurs in Southeast Asia," in Timothy Brook & Hy V. Luong (eds.), *Culture and Economy: the Shaping of Capitalism in Eastern Asia* (Ann Arbor: The University of Michigan Press, 1997).

[60] See Danching Ruan et al., "On the Changing Structure of Social Networks in Urban China," *Social Networks* 19, 1 (January, 1997): 75-89.

When an enterprise needs to expand and to absorb external investment, a family enterprise becomes an obstacle. In the case mentioned earlier of an entrepreneur whose firm absorbed external legal-person investment, the entrepreneur not only re-registered his enterprise as a limited company but also had his wife and his brother-in-law withdrawn from the enterprise. He explained to me that the company should be institutionalised now and he did not want it to become a family company.[61]

During my fieldwork in China, I also found that the family enterprise was being disparaged in business circles and the media. The prevalence of family-style management in private enterprises was singled out as one of the factors causing a bottleneck to their development today. Problems were raised regarding family-style management included the lack of professionalisation, nepotism and indeterminate property rights among the family members. A nation-wide survey of 100 private entrepreneurs published in 1999 reported that no respondent supported family-style management; 44 respondents objected to it; the other 40 thought that it was inevitable but that entrepreneurs should try to pick only competent relations.[62] The attitude against the family enterprise is associated with the old Communist antipathy against big capitalists. The bureaucratic capitalism of the Kuomintang era is usually reduced to four big family businesses.[63] Hence, the Party has tried to set up institutions to discourage the revival of big family businesses, as in the adoption of the Company Law noted in Chapter 3. People commonly tend to subscribe to this anti-family-capitalism, as they identify themselves with the official account of the history of the Kuomintang era.

[61] Interviewee 2.
[62] *Guangdong dajingmao* [Guangdong Great Economy], 130 (June, 1999): 75.
[63] The four families referred to the families of Chiang, Soong, Kung and Chen.

The negative response towards family-style management was also prevalent among my interviewees. When I asked them whether they had family members and relatives working in their companies, some of the interviewees replied to me very sensitively. One said, "No, we didn't open a family company, and no relatives are allowed to take any position."[64] Another said, "No, we don't want to make it a family business. I well know the hazards of doing so."[65] In another case, an entrepreneur had worked in a company's department that was under the charge of his relative. He felt that it was very inconvenient to work under a relative, and that he would rather cope with people who were not kin (*wairen*) than with kin.[66] He applied his experience to his opinion of the family enterprise. He said, "my company is a partnership enterprise, and one partner absorbs his relatives into the company; another would follow suit, and then it becomes very difficult to manage." Hence, he did not allow the relative of any shareholder to work in the company. Even though his wife was unemployed, she was not allowed to join the company.[67]

Of course, an opposite opinion was expressed by the interviewees from family enterprises. The interviewee from the pharmaceutical company pinpointed that the management of family enterprises was more united. This was the advantage of his own company.[68] The PC manufacturer in Guangzhou was not a family enterprise, but the owner employed his relatives. He stressed that he picked the competent regardless of whether or not they were his relatives. However, it was more demanding for his

[64] Interviewee 19.
[65] Interviewee 49.
[66] He meant that the kinship between the superior and the inferior would result in more embarrassing situations, in case conflicts happened between them for the working. It was because their relationship involved not only impersonal but also personal one.
[67] Interviewee 47.
[68] Interviewee 4.

relatives to work in his company. Their promotions would be slower lest the entrepreneur be subject to criticism.[69]

Here I do not attempt to make any judgement as to whether the family enterprise is efficient. But it is sufficient to reiterate that the IT sector does not adhere to entrepreneurial familism; and societal doubts about the efficiency of family business further reinforces this entrepreneurial attitude against it.

Concluding Remarks

This chapter presents the backgrounds of private enterprises and entrepreneurs in my sample and shows that these private enterprises have developed into a more autonomous type of economic entity than previous accounts have depicted. Most of these private entrepreneurs have got rid of many of the fundamental constraints previously imposed upon them by state institutions. The corporate structure of such enterprises has become increasingly complicated. This reflects the fact that some of these enterprises have crossed the threshold of an initial development stage and have diversified their business.

The state is less able to patronise the private entrepreneurs by allocating access to urban privileges under the outmoded *hukou* system.[70] The same is true of the vanishing practice of *guakao*. This well-educated group of entrepreneurs instead enjoys a high degree of autonomy. They present a strong impression that they have been able to carve out their careers through their professional knowledge and sensitivity to market demand rather than any particular official treatment.

[69] Interviewee 41.
[70] Hein Mallee has pointed out that even though the *hukou* system was transformed during the reform era, it remained an effective instrument of control for the state by manipulating the membership of urban *hukou* to maintain a "client" urban group. See Hein Mallee, op. cit.

However, it does not follow that the pre-reform institutions have nothing to do with the path of these enterprises' development. We have observed how the *hukou* system provides a stumbling block to the forming of family businesses in the urban IT industry. And the Communist notions about "family capitalism" reinforce this consequence. The legacy of Chinese communism is shaping the processes of transformation.

Chapter 6: The Business Linkages of Enterprises

This chapter examines the inter-organisational business linkages of enterprises in order to evaluate to what extent the private enterprises in my sample depended upon particular and exclusive linkages for survival and development. I will pay most attention to the linkages with official and semi-official agencies that are directly related to their business affairs. An evaluation will be made in terms of five aspects: business trading, the regulatory regime, financing, horizontal connections and corporate amalgamations, and political capital. I will focus mainly upon cases in IT industry supplemented by some typical cases not derived from my field studies.

Business Trading

Dyadic Trading

The entrepreneurs in my interviews usually entered the IT business through one of two paths. First, their training and work background in computing engineering facilitated their engagement in the business. The second was the pull effect of the sunrise industry that lured many amateurs into the business. For example, several of the entrepreneurs without any computing training background but working or living around Zhongguancun were fascinated by the electronic "frenzy" there and thus went into the industry.

Despite this, the first course accounts for the vast majority of my cases. Computing engineers are better able to survive in this industry because they usually possess their own particular niches and product-lines that tend to be in short supply or cannot be substituted in a short time. The early business entrants, who started their businesses at the end of the 1980s and the early 1990s, faced the least competition. Many of them were engaged in a dyadic trading business in that the users of their products and/or service were usually limited to official and semi-official agencies or commercial firms. The producers or service providers seldom needed to take on marketing and other post-production processing costs. But it was not a one-touch service, so they needed to keep a long-term trading relationship with their clients.

Lack of competition was usually the good fortune of early entrants among the professional software companies. The late entrants faced fiercer competition and needed to create good *guanxi* with their clients. For example, a small system integration service provider, who founded his firm in 1996, told me that his first project came from a friend's recommendation. He explained, "no one gives a project to a new firm… But I have to have an initial client, so I relied upon my friend's referral."[1] Another system integration service provider, who founded his firm in 1999, also relied upon an old connection built up when he worked in a state-owned computer company.[2] This personal connection helps to lay a foundation, but entrepreneurs have to accomplish the rest by themselves. As the first entrepreneur pointed out, "personal referrals gradually decrease now .. But once I successfully completed the first project, it could help to generate others. If I could secure a project from a big firm, it would have a great positive effect."[3] To maintain good *guanxi* is to create a good reputation for "professional ties," as Chen Chieh-hsüan suggests. The IT entrepreneurs whose clients

[1] Interviewee 38.
[2] Interviewee 33.
[3] Interviewee 38.

were corporate users stressed that the weaving of their trading web depended highly upon customers who were content with products or services recommending their companies to other users.

Although *guanxi* ties can help bind the trading parties, the increasingly fierce competition is unravelling the ties at the same time. Between the upstream and downstream enterprises, the former try to minimise dependence upon one firm by creating as many partnerships as possible so as to gauge the performance of each partner. In the IT industry, overseas linkages provide a specific origin for many firms. The core business of two software companies in my interviews was to provide an offshore service for Microsoft. This service mainly involved "localisation" of Microsoft software packages. When Microsoft entered the Chinese market in the early 1990s, it first had to localise its English software packages. Instead of doing the task itself, the Microsoft looked for small local companies to undertake the jobs. Outsourcing is a common practice for American IT corporations. Microsoft contracted out the jobs to several rather than one company. As a result, two of the companies in my sample undertook "localisation" jobs for different Microsoft software packages.

This practice is not exclusive to foreign companies; the same practice is applied among domestic enterprises. One of my cases was a sales agent for Legend products. The agency was founded in 1993. The owner had been a branch manager of Legend before he opened his own company. It was in his advantage to take on this business. When Legend started producing PCs in the early 1990s, the sales agent was one of the first dealers of Legend products. The agent had not made any profit in the first years, but Legend PC secured a market edge from the mid-1990s. Between 1995 and 1997, the agent's company took off, averaging a 300% annual sales growth rate. The interviewee, who was a senior manager, stressed that his company's success relied upon a conservative development strategy, embarking upon no speculative businesses. Its competitive strategy relied upon a lower profit rate and better after-sales services. Despite a very good relationship with Legend, the interviewee pointed out that the agent had to fulfil many conditions, like a specific sales volume, required by Legend. Moreover, his company was not the sole agent for Legend. Many other agents compete with this agent, even though he is ranked an "A" class agent now. The above cases reflect that *guanxi* may help entry into a business, but it cannot guarantee the success of the business. Alternatively, *guanxi* becomes open, competitive and non-exclusive. Many enterprises among my cases tried to create a competitive environment for their downstream local dealers to boost the sales of their products. The non-particularistic treatment in the above cases may be attributed to a business-oriented relationship among profit-seeking organisations. But what about relations with semi-official agencies?

China Telecom is the largest state-owned telecommunications corporation. It both regulates and embarks upon telecommunications business and monopolises the infrastructure of networks. Despite this monopoly, China Telecom has been diversifying and commodifying its services, for which it needs to absorb new technology. The private IT enterprises are one of its sources to upgrade technology. The Guangzhou-based Suntek Group, for instance, is an important partner of China Telecom. The Suntek Group is adept at telecommunications-related software engineering, including having developed an automatic payment calculation system and other tele-commercial services for the state's telecommunications and post agencies. These kinds of technology were poorly developed before the mid-1990s. Suntek is now a backbone enterprise in Guangzhou. Despite its long-term partnership with China Telecom, Suntek faces ever more competition from new entrants. The telecommunications company that moved its headquarters from Changsha to Guangzhou, for example, is a head-on competitor with Suntek. The entrepreneur of the company whom I interviewed had worked in Suntek before he set up his own company. His company also specialised in telecommunications-related software engineering. When I interviewed the entrepreneur, he told me that his company had successfully scrambled for three out of five new projects from China Telecom, beating out other competitors, including Suntek. I asked him whether he employed *guanxi* to secure the projects. His reply was affirmative, but he defended this, saying that both technology and *guanxi* were equally important, and the technology of his company was more advanced than that of others.[4] No matter what happened behind the scene, competition becomes fiercer in general. High quality service, competitive prices and technology upgrading are basic strategies of competition among the enterprises in this study.

Guanxi further loses its function in the burgeoning Internet industry. Business deals in the industry are almost always conducted with little face-to-face contact. What customers take into account is the service output and price. This "virtual" business world *per se* has diminished the need to cultivate personal relationships. An entrepreneur who opened an on-line trading website in Guangzhou claimed that his on-line business orders came from as far as Xinjiang and Gansu Provinces.[5]

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[4] Interviewee 30.
[5] Interviewee 50.

However, the development of e-commerce remains at a germinal stage. The on-line business still needs a synergy of diverse business participants to gear up a momentum. Sparkice spared no efforts over the past few years to seek out various business partners to launch a variety of on-line business solutions in order to accelerate the maturity of its services. It is impossible to rely heavily upon *guanxi* to achieve the goal, because it needs a great deal of high-technology linkages, and e-commerce is a highly risky business.

Market Trading

While many software engineering companies provide professional software and untraded professional services or offshore services for other business firms in which it is easier to build up a relatively solid trading relationship, many other software developers and retail-related firms need to appeal to dispersed individual consumers. Education and game software developers, software retailers and PC manufacturers are examples. Among my cases, there were five education and game software developers, two software retailers and two PC manufacturers, whose businesses operated in a more uncertain marketplace in terms of customers. Some of them were successful, but others not.

A typical successful case is CSC. The rise of CSC is tantamount to a miracle. It was founded in 1991 and took off in 1994 by means of a software package for secondary school students. The market for education software was absent at that time. The popularity of PCs remained very low and people had never employed computers for teaching purposes. Therefore, CSC needed to create rather than seize the market. In order to create demand, the CSC organised a demonstration in Beijing and invited

20,000 students of secondary schools to test the software. After the interest of students was aroused, it further stirred up a spending desire among parents. The CSC announced a promise: anyone who bought the software package but failed to enter university could have a refund. As a result, over 20,000 software packages, priced at 1,800 yuan — a very expensive commodity in China — were sold out in a month. The marketing strategy was the key to its success.

Other surveyed education software developers were late entrants and less aggressive in their marketing strategy. They were businesses with little initial capital. At the same time, the costs of operating in this business were rising, including research and development (R&D), marketing and other post-production processing, but the pricing had to be kept as low as possible to sustain a competitive edge. Furthermore, the software industry faced a popular and intractable problem — pirated software. The software retailing business bore the brunt of this. The two companies in my sample that ran software chain shops in Guangzhou needed to directly struggle against competition from pirated software.

One of the game software developers among my cases developed two popular game packages before 1998 but almost collapsed shortly before I visited the enterprise due to rampant pirated software. It has already switched to on-line business.[6] Most firms engaged in non-professional software development face the problem of piracy, but the government fails to crack down on it, to the point that it has become a hindrance to the development of the industry.

[6] Interviewee 8.

Whereas software development requires high-level professional techniques, PC manufacturing resembles traditional assembly-line production. One of the two PC manufacturers had developed from a small "screwdriver assembly" workshop in Beijing. A Guangzhou-based enterprise developed from a hardware trading firm and started up PC production in 1997. Now the two manufacturers have established their own brand-name PCs. The former was selected as one of the ten best-known PC brands in Beijing in 1998. The latter was a rising brand in South China. The owners of the two companies were not computing engineers, but they were proficient in aspects of commercial strategy. Both paid attention to building up their business image. When there were only a few domestic brand-name PCs in China, they created their own. In order to give consumers confidence, both companies spared no effort to earn various quality certificates. The PC production of the Guangzhou-based company passed the ISO9002 quality standard. The Beijing-based company took the lead to provide free after-sales service for buyers in 1994, which has become a must today for all PC vendors. Entrepreneurship accounted for the take-off of these two companies.

Although the early entrants faced greater market uncertainties, the risky environment appears to have led to high profitability among those entrepreneurs who caught a good business opportunity, the late entrants were confronted with a maturing market in which the marginal profits were decreasing. As a software developer who had been mainly engaged in computer hardware trading since 1988 told me, "in 1988, all people were quite stupid. You gave them a quotation; they usually believed that. Hence, the profit rate was very high. But now, conversely, they give you a quotation, '7,000 yuan for a Pentium computer.' If you don't accept it, they find other dealers."[7] Now many of the market sectors in China have been transformed from a seller's into a buyer's market. Suppliers are seldom able to secure monopolised resources or control information so as to manipulate the market.

Government Trading

Albeit the market plays an increasingly significant role in economic development, the state is one of the participants in the market. The official and semi-official non-profit agencies (*shiye danwei*) account for a considerable share of IT consumption. For example, the top financial and management software developer, Ufsoft, relied upon customers from the state agencies during its initial development. It should be noted that the market for financial software was absent at that time and state-owned companies had no sense of the potential of the business. Wang Wenjing, the president of Ufsoft, who had worked in the State Council and had participated in a project to computerise accounting for state organs, anticipated good prospects in the business and thus quit his state job to start an IT outfit in 1988. Due to lack of competition, Ufsoft has become the No. 1 financial software developer nation-wide since 1991.[8] But there are now many rising, highly competitive domestic software developers in this speciality. In my study, four other enterprises among my cases were in the same business and considered Ufsoft its major opponent. Hence, Ufsoft needs to incessantly enhance its competitiveness so as to keep the leading edge. It now also has switched more to relying upon customers from business firms. Government contracts

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[7] Interviewee 19.

[8] See Zhang Guohua (ed.), *Zouxiang tizhiwai de guanyuanmen* [Officials Who are off the State System] (Beijing: Zhongguo jingji chubanshe, 1999), 401-15.

and orders did help his company to take off,[9] but at the same time, Ufsoft significantly contributed to the forming of the market of financial and management software, as it took the lead to create the market.

In many of my cases, users of new technology were official or semi-official non-profit agencies. Besides demonstrating innovations in their techniques, entrepreneurs needed to employ various means to lobby for the adoption of their products. For example, a company in my cases that developed a multi-media network teaching system had primary and secondary schools as its customer targets, and the company needed to lobby the local state's education departments to recommend the system to schools.[10] It is difficult to assess to what extent corrupt practices behind the scenes determined the deals, but it was conceivable that government officials would not be as business-oriented as the personnel in business firms. Every entrepreneur recognised that to maintain good *guanxi* with the officials was a prerequisite to making deals with the government.

On the other hand, the state is reforming the government procurement system by introducing a competitive tender system so as to establish a fair and transparent procurement system and to reduce the expenditures of the government. Three of my cases has participated in such a tender and succeeded in their bids to obtain some government contracts — the two PC manufacturers and a hardware dealer in Guangzhou. The dealer was the only one among them to charge that even though some of the tenders were fair, most were not and the officials exercised too much discretion.[11]

[9] Interviewee 9.
[10] Interviewee 19.
[11] Interviewee 36.

Despite this, it should be noted that the private sector was not excluded from the government's purchases. In 1999, the Guangzhou-based PC manufacturer beat other big competitors, obtaining the biggest PC purchasing contract offered by the Guangzhou government.

To be sure, the "pies" offered by the government are not necessarily delicious. The peasant entrepreneur who bought a SOE in the GETDZ had undertaken a small civil engineering project on behalf of a township government in north Guangdong. The civil engineering project was a "key point" project in the province, so the entrepreneur supposed that his payment to undertake it should have been very secure, but due to fiscal mismanagement by the township government the entrepreneur had not been paid after the completion of the project and needed to take the government to court.[12]

In light of such incidents, enterprises, like their upstream trading parties, try to diversify their products and sources of businesses to minimise their dependence upon one business link, no matter whether the links are with state agencies or with other profit-seeking organisations. Despite good performance in the sales of the Legend products, the sales agent of Legend was searching for other directions for future development. It started developing its own products and entered into Internet services. The Beijing-based PC manufacturer invested in R&D, developing its own software for its PCs and exploiting other IT products such as a video-on-demand system for the hotel industry.

[12] Interviewee 39.

The Regulatory Regime

The state regulatory regime is usually regarded as a source of distortion during marketisation. But before the mid-1990s, the IT industry was basically an unregulated sector in China. It is interesting to note that while the state is carrying out de-regulation in other sectors, the IT industry has just started to be regulated by the state. For example, financial software needs to be approved by the Ministry of Finance. The production of all brand-name PCs needs to be supervised by the State Bureau of Computer Quality Monitoring and to be approved by the Ministry of Information Industry as of 1996. Despite the regulations, the competition has not been basically distorted. Non-brand-name PC clones are still available in the market. It is not difficult for software products to get approvals from corresponding state authorities, unless the products relate to sensitive issues. Although the Ministry of Finance annually proclaims a list of officially approved financial software, it does not help to promote the brands on the list, as it is the basic requirement for every developer to get the approval.[13]

Some entrepreneurs among my cases nonetheless made use of the state regulatory authorities to enhance the reputation of their products. In one of my cases, an entrepreneur developed a software package for estate management when he worked in the Ministry of Construction. In 1996 he quit his job to open a company in Beijing to sell his software. By virtue of his old connection with the Ministry of Construction, his software easily passed the examination of the Ministry and he made use of this to promote the reliability of his software, while the same products of other companies had

[13] Interviewee 38.

not passed the examination yet.[14] Despite this advantage, his company failed to enter the market profitably in Beijing because a big company that had been spun off from a renowned university in Beijing had started the business earlier and had already seized the market. As a result, he turned his target to the market in South China.[15]

The consequence of another case was different. A software engineer in Guangzhou developed a budgeting software package for the building industry. His software was highly recommended by the Guangzhou Urban Construction Committee because of his good connections with a state-owned computer company that was affiliated with the Municipal Science and Technology Committee. The referrals from the Committee constituted 30% of the turnover and his software also accounted for a majority share in the Guangzhou market. But he also explained that his software was tailor-made for the situation in Guangzhou. It could not be applied to other areas. By the same token, it was difficult for the software from other areas to enter the Guangzhou's market. That was another point that helped to explain why his software could take command of the local market.[16]

Actually, the government seldom restricts the development of any practical technology with economic value, but one of the Party's concerns is the "spiritual pollution" spread by the electronic media. Besides the Internet, education and game software in particular are potential sources of this. In order to control "spiritually harmful" products, the government stipulated in 1996 that all education and game software developers have to buy ISBNs for their software packages from book

[14] The examination only provided an official quality assurance to customers. Those who have not passed the examination could still sell their products.
[15] Interviewee 10.
[16] Interviewee 37.

publishers. All of these products are regarded as electronic publications. Book publishers, instead of any government agent, play the role of censor. If any problem occurs, the publisher will take the responsibility. As the publishers are monopolised by state-owned companies and the ISBNs are not evenly distributed, there is a lack of sufficient opportunities to secure ISBNs. The big book publishers usually hold more of the ISBNs. These publishers benefit by selling ISBNs to software companies without having to commit any of their own financial resources.

Despite this, market forces still exert an influence. The book publishers compete with each other. One of the software game developers told me that he first bought an ISBN from a renowned university book publisher, but he found that the publisher's reputation had nothing to do with his success in marketing his software. Moreover, the book publisher was very inefficient in passing it through its censorship system, and the price charged him was also too high. He said he could now buy the ISBN from other publishers which were more efficient and cheaper.[17]

Another sensitive issue is information security. The Chinese has government just decided to prohibit the sale of foreign encryption technology that protects electronic communications from eavesdropping. In Guangzhou, I visited a private company that had embarked upon encryption technology. The interviewee told me that it is now difficult to enter into the business, because the government considers the technology to relate to national security. Hence, private entry is strictly controlled and foreign investment is not allowed; otherwise, the interviewee remarked, there is no security at all.[18] It was lucky that the company was an early entrant and now received significant

[17] Interviewee 8.
[18] Interviewee 51.

state support. Similar controls are also applied to ISP. The ISP is a gateway to the Internet. In order to control information flows, foreign companies are not allowed to operate in the ISP business, and it is also difficult for private businesspeople to obtain an ISP licence. Moreover the ISP licensee needs to pay an expensive fee to lease lines from China Telecom. This makes ISP a loss-making business today and thus discourages investment by private capital. But some interviewees believe that to boost the IT industry, the government will have to relax controls over the ISP sooner or later.

To be sure, where there are grey areas or a vacuum in certain policies, connections with the bureaucracy remain very important. There has always been a wide policy gap in the IT industry, as the rapidly evolving industry is prone to create new vacuums that laws and state policies fail to cover. In 1997, two brothers in Fuzhou started providing a very cheap long-distance telephone service through a new technique — Internetphone (IP) — without permission; and in so doing they trod heavily on the toes of China Telecom, which monopolised the international telephone service. Hence, in January 1998 the latter ordered the police to confiscate the equipment of the brothers' company. The brothers then took China Telecom to court in Fuzhou. The court ruled that the IP service was not subject to China's state telecom monopoly. Despite that, the Ministry of Information Industry at last banned the private IP service and only gave licenses to three state-owned companies to operate the service.[19]

Edward Zeng, the CEO of Sparkice, well understood the linchpin of this issue. Hence, he sought a partnership with China Unicom from the outset. Furthermore, as the

[19] See *China Daily*, 21 January 1999; 23 January 1999; 26 March 1999 (Internet edition: www.chinadaily.com.cn); *South China Morning Post*, 22 January 1999; 25 January 1999; 1 February 1999 (Internet edition: www.scmp.com).

Internet café was a new business not covered by state regulations, he had to carefully toe the government line and even actively took part in drafting the rules to govern the business. As Zeng pointed out, "if you work together with the government so that the government thinks that it is in control, then things will gradually become more and more open."[20] Zeng's strategy was essential. Some Internet cafés were disguised places for gambling and prostitution and if the government simply banned the operation of all Internet cafés, that would be a tragedy to his business. Moreover, his ultimate goal was not in the Internet café business but e-commerce. A close connection with the government could help him to get access to government information and simultaneously exert influence upon policy making.

It should be noted that such a connection with the government is a common strategy for "survival," but could not guarantee the success of his business. First, e-commerce is a new, immature business with a high degree of uncertainty. Second, there have been many new entrants into the business in the late 1990s. Most important, the business ultimately needs to appeal to business circles and private customers who are willing to accept the new commercial concept. To be sure, e-commerce is a market-friendly business in the sense that it is *per se* enhancing the flow of information and helping to reduce transaction costs. In this regard, the more open and less monopolistic the business environment is, the more promising the business is. Hence, the interviewee from Sparkice criticised the monopoly of China Telecom as a negative element of the business. It more or less retarded the growth of Internet users in China. The growth of

[20]Lijia Macleod, "Fight for the Right to Party," *Newsweek* (8 February 1999): 13.

competition does not cause problems now, he remarked, because the first thing the business should do is to create the market, not to crowd out competitors.[21]

A similar case was found among the non-IT enterprises. Yuan Yongmin, the owner of a pioneering light aircraft manufacturing company, took a risky gambit, in that the aviation business is closely associated with national defence in China. But Yuan told me that he had been ignorant of the crux of this issue. He said that if he had known that in advance, he should not have taken up the business. In spring 1993, Yuan bought a patented blueprint of a light aircraft from Nanjing Aviation & Spacecraft University and sought to register a company in Haidian District in Beijing to launch production. When he went to the Bureau of Industry and Commerce Management to register a new company, no official dared approve the registration, as it would create a precedent. Luckily, it was right after Deng Xiaoping's southern tour in 1992, and the local government wanted to put forward some advanced projects and so approved his registration. His success in this registration more or less hinged on his long-lasting relationship with officials in the Haidian District Government. Since the early 1980s, Yuan had been assigned to help revitalise many of the ailing state-owned food shops in Haidian. However, he found that the returns were not commensurate with his contribution. Hence, in 1986, he opened his own restaurant by buying out a state-owned noodle restaurant. But he carefully kept up his close relationship with the government. As mentioned in the last chapter, he was a PPCC member and concurrently the vice-chairman of the Haidian Private Enterprise Association and Haidian Federation of Industry and Commerce. While I went to interview him, he was hosting an official from

[21] Interviewee 16.

the Ministry of Water Resources and Reservation in his restaurant. A new project had occurred to him — he wanted to produce tourist vessels. Therefore, he needed to "communicate" with the corresponding officials in advance so as to improve the feasibility of this innovative project.[22]

Financing

Difficulty for private enterprises to get access to bank credit has been plaguing the development of the private economy. In China, financial institutions are basically monopolised by the state-owned banking sector. In past years, they allocated over 70% of their loans to the state sector, even though a considerable share of the loans was non-performing. The credit officers were not held responsible for these bad debts, but the loans to the private sector were a different matter. As a result, while the non-state sector contributed heavily to China's economic growth, it was barely financed by loans.

The reform of the banking system in recent years attempted to rectify the situation. Branches of the banks are now held responsible for new loans that go bad. Hence, more loans are going to the better performing private enterprises. It is estimated that 40% of new bank loans are going to non-state firms and the interest rate charged is the same as state enterprises pay.[23] Relatively, the state-owned enterprises are now getting hard to have easy credit, merely by virtue of ownership identity. The state-owned software company in Guangzhou also found it difficult to obtain loans, even though it was founded by local state authorities.[24] Yet, it remains difficult for most

[22] Interviewee 20.
[23] Jim Rohwer, "Where Does China Get its Money?" *Fortune*, 13 (5 July 1999): 67.
[24] Interviewee 32.

private enterprises to get access to bank loans. Despite scrapping the bias against them, lending policy minimises risk-taking in the loans extended to the private sector. Banks tend to adopt a policy of zero risk lending and accordingly only big private enterprises now find it easy to get loans. The majority of the private sector — the small firms — remains inaccessible to bank loans.

Among my cases, only twelve enterprises have ever obtained loans from banks, of which eight were from the IT enterprises (See Table 6.1). Three of these are the largest conglomerates — CSC, Ufsoft and Suntek. As for the remaining five cases, the entrepreneurs expressed the view that bank loans were not significant in their corporate financing. As these were short-term loans, from six months to one year, these could only help to solve the problem of capital turnover for a short period. They were not supposed to use the loan for any long-term investment. In fact, most of them now seldom applied for a bank loan. For one thing, the application procedure was too complicated and time-consuming. For another, the amount of credit was very small, depending upon the value of their collateral, usually several hundreds of thousands yuan in these cases. This amount was far from enough for investment in the IT industry.

One of the above five cases was the Beijing-based PC manufacturer. In view of its good performance, the committee of the Experimental Zone for New Technology Industry in Haidian recommended the enterprise for a bank loan amounting to 800,000 yuan, with the committee and an insurance company as the guarantors and no need for collateral. In spite of this preferential treatment, the entrepreneur was not particularly appreciative, commenting that it was just a "symbolic encouragement to a private enterprise."[25] The 800,000 yuan did not help the development of the enterprise very much.

Table 6.1: Bank Loans to the Enterprises

	N	Having obtained bank loans	Never asked for bank loan Reasons 1	2	3	Being asked to borrow but declined	Failure to get access to loans
			Not yet necessary	Supposed it was difficult	Not a good financing channel		
IT Enterprises	42	8	17*#	10*	3#	3	3
Non-IT Enterprises	8	4		2			2

*One interviewee expressed that his company did not need any loan but he also supposed that it was difficult for his company to borrow money from banks.

#One interviewee expressed that his company did not need any loan and thought that bank loans were not a good financing channel.

Five cases asked for loans but were not successful, while the majority of my cases never asked for bank loans (See Table 6.1). It did not follow that they needed no loans. Twelve interviewees instead anticipated that their enterprises could not get any loan from the banks. Some of them attributed the problem to discrimination against private enterprises. The paramount factor, though, was that they did not possess the recognisable assets as collateral.

In Beijing, the government is currently promoting the development of high-tech industry and trying to help finance the small and medium-sized high-tech firms. Various government departments have jointly set up a venture foundation for backing up bank loans to this type of enterprises. The plan originally guaranteed that the enterprises

[25] Interviewee 2.

could borrow money from the bank without requiring collateral, as long as the government acted as the guarantor and paid a certain amount of funds as a deposit. However, ultimately the bank insisted that no special treatment applied to this plan, which disappointed some of the entrepreneurs, whom I interviewed, who had intended to apply for it.[26]

Under the policy of zero risk lending, as noted, small firms were usually not qualified for any loan without offering collateral — and the sole collateral the bank accepts is real estate. For the small IT enterprises, however, the most valuable assets are their intellectual property. They seldom possess real estate. By contrast, other industries, especially the manufacturing industry, can turn to their plants as collateral. Hence, the non-IT cases, of which most had real property, were more successful in getting loans. As a result, no matter how good the performance of an IT private enterprise, banks did not lend money until its profitability attained a level high enough that the risk rate of credit was almost as low as zero. But an enterprise that reached this level might not need any loan.

While many private entrepreneurs are thirsty for loans, on the other hand a few of them do not want to "drink." It is interesting to note that three enterprises among my cases claimed that the bank urged them to borrow money, but they were indifferent to the offer. They were well-performing companies that had just experienced a take off. They already possessed sufficient capital for daily operations. To be sure, if they launched an ambitious new big project, bank loans were still essential. But the conservative policy of the bank failed to meet their business demands. In one of the

[26] Interviewees 7 & 19.

three cases, the entrepreneur claimed that his company was planning a new project that needed tens of millions of yuan, but the bank only granted it credit up to several millions of yuan and therefore he declined the offer.[27]

Another interviewee gave a different account of the phenomenon. The entrepreneur explained that the speed of his capacity to expand his business operations failed to catch up with the influx of profits.[28] In the transitional economy, there are many opportunities for private entrepreneurs to make big profits to the extent that these "upstarts" could not well master. To these enterprises, bank credit is not crucial for the time being.

Furthermore, in part because of the long-term conservative lending policy of the banks, the private enterprises are used to being self-financed and retaining a high ratio of their earnings to take care of most of their financing needs. For this reason, too, some of them avoided borrowing money from the banks. The most extreme case was a rapidly growing private company, the Giant Group (*Juren jituan*) in Zhuhai. It ambitiously attempted to build a 70-storey skyscraper in the early 1990s. Since the company had never applied for loans, by the same token the owner never considered borrowing money to finance the construction until late 1993 when the government enforced austerity measures. As a result, the company needed to put all of its available funds, which should have been allocated to other promising projects, into this project. This eventually threw the company into a financial crisis in 1997 and now the owner is trying to save his company from bankruptcy.[29]

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[27] Interviewee 30.
[28] Interviewee 41.
[29] *Zhongguo qiyejia* [China Entrepreneur], 144 (September, 1997): 7-8; *Nanfang zhoumo* [Southern Weekend], 7 July 2000 (Internet edition:www.nanfangdaily.com.cn).

Seventeen entrepreneurs responded that it was not yet necessary for them to borrow money (See Table 6.1). Some of them were newly-founded companies and the others had enough cash to operate their firms or had not reached the threshold of their next development stage. In addition, some entrepreneurs preferred other financing channels — absorbing new share capital or forming joint ventures with other companies. For the IT industry, venture capital is now regarded as a better capital source. One of these enterprises was fully funded by a venture capitalist from the United States.

Three entrepreneurs remarked that, in particular, bank loans are not an appropriate financing source for the IT industry because of the short-term nature of the loans, whereas the cycle of pay-offs in IT takes at least a few years due to the on-going development of the computer and Internet market. Moreover, as noted above, the amount of a bank loan to the private sector is too small to support much investment. Venture capital can suffice for the demands of the industry. Some of the entrepreneurs revealed that they had contacted venture capitalists for cooperation or vice versa. To be sure, the venture capitalists to which most of these entrepreneurs are eager to get access are foreign ones, mainly from the United States. The development of domestic venture funding remains at an embryonic stage and it is short of funds to support scattered small private firms.

The financing channels are becoming more diversified for the private sector. To go public to acquire funding is a developing source. To be sure, to list a private company on the domestic stock market is very difficult because most of the quotas for initial public offerings (IPOs) are allocated to SOEs. Just a few big private companies have entered the primary market up to now. However, the past few years have experienced a trend of relaxation, especially since the newly adopted Securities Law lifted many restrictions upon the individual holding of equities. Among my cases, the Ufsoft Group was applying for an IPO while I visited the company in June 1999. When I interviewed the president, Wang Wenjing, on the phone, he felt confident that his application would be approved in view of the new law. Right after my fieldtrip of Beijing, the application was approved and in early 2000, it was re-organised into a shareholding company — a prerequisite to an IPO.

However, to complete all procedures for the formal listing is very time-consuming, so some private enterprises prefer to opt for an indirect listing. An indirect listing or "rear door listing" refers to the takeover of listed companies in the secondary market. By this method, the new holding company can make use of a so-called "shell" company to achieve the aim of raising capital from the public, with no need to reorganise the company into a shareholding company. It is a common practice in stock markets around the world. To be sure, rather than taking over a listed company through market trading, such takeovers have been usually achieved in China through an agreement between the purchasers and the original holding companies.

During the period from 1997 to 1999, several private enterprises took over state-owned listed companies in this manner. One was the CSC Group, which in April 1999 took over a Harbin-based listed steel company, Yacheng Steel.[30] Yacheng transferred 52.3% of the corporate shares to CSC in exchange for 34 million yuan, 80% of the shares of a CSC subsidiary and the copyright to a software package of CSC. Under this

[30] One of the reasons why Song Chaodi, the president of the CSC, chose the Harbin-based company as the "shell" was that Song was a Harbiner. See *Beijing jingjibao* [Beijing Economic Daily], 25 April 1999: 1.

agreement, CSC holds 28% of Yacheng's shares, an amount large enough for it to become the largest shareholder of Yacheng. Yacheng was renamed as CSC, known as *Kelihua* in Chinese.[31] By the same method, the Suntek Group purchased the state and corporate shares of another listed company at the end of 1999, becoming the largest shareholder holding 35% of the shares of the company.[32]

Small IT companies have no chance of going public in the domestic market. But the foreign stock market seems more promising, as there are some second-board markets specifically for high-tech startups. Sparkice was planning to go public through NASDAQ. An Internet service enterprise among my cases succeeded in going public by buying a "shell" company on the securities market, OTCBB,[33] in the United States, raising 70 million US dollars from the market in December 1999.

In the past, whoever controlled capital resources could patronise enterprises in China. Previous studies noted that personal connections were indispensable for private entrepreneurs to get access to bank loans, because of the political bias against the private sector.[34] But the recent reform of the banking system has marketised the operations of the credit system. Yet, most private firms continue to find it difficult to obtain loans from the banks, even though the big private firms have become favourite customers of the banks. This is reflected among my cases, especially among the IT enterprises. As noted, the banks are now held responsible for bad debts and therefore have become more cautious about providing credit. This does not mean that personal

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[31] See *Beijing jingjibao* [Beijing Economic Daily], 20 April 1999: 1.
[32] *Nanfang dushibao* [Southern Urban Daily], 13 January 2000: 30.
[33] OTCBB is the short form of "Over The Counter Bulletin Board." The listing requirement of OTCBB is less demanding than that of NASDAQ.
[34] For example, see Andrea Lynne Robert, *The Political Impact of China's New Private Entrepreneurs*, PhD Dissertation (University of California, Berkeley, 1997), 72-93.

relationships become meaningless, but a personal relationship cannot override the institutional constraints imposed upon the bank. On the other hand, after decades of deterioration of state financial and fiscal institutions, the state is short of funds to directly finance the development of most industries — especially the IT industry, which tends to demand non-traditional financial services. That is one reason why stock markets need to be established in China. An entrepreneur who had newly founded an enterprise at the Entrepreneur Park in GETDZ complained to me that the government had promised to grant him some interest-free loans, but he never got any, and so was very discontented with the government.[35] The state, in short, is now less able to financially patronise the private sector due to its weakening fiscal muscle.

Horizontal Connections and Corporate Amalgamations

The foregoing sections discussed inter-organisational linkages in terms of vertical trading, regulatory regimes and financing connections. This section focuses upon horizontal business relationships, such as component trading, technological connections, joint projects, and joint ventures.

For the IT industry, the capability to master new and advanced technology is an overwhelming condition to gain a leading edge. And this type of technology usually originates from foreign countries; hence, the entrepreneurs need to keep abreast of development trends abroad, especially through the Internet and e-mails, to access global information. As an IT entrepreneur claimed, if one day the Chinese government decides

[35] Interviewee 44.

to close down the Internet, he would immediately leave for other countries.[36] Foreign information and connections are very critical for the IT industry, because the core technology remains in the hands of foreign IT giants. The domestic companies have no choice but to rely upon them.

For example, all PC manufacturers cannot but buy licences from Microsoft to install Windows into their PCs. But the price of a licence sold to small PC manufacturers is double that of large companies, which saps the competitiveness of the former.[37] Application software development is the leading edge for many local IT firms, but they still have to rely upon imported hardware and professional software as the platform for R&D. Comparatively speaking, the IT firms in China are bound to a handful of foreign IT corporations, which monopolise the key core technology, more so than they are beholden to any local state or non-state institutions.

The technological connections with foreign IT companies are, in short, an essential inter-organisational linkage. Many IT enterprises among my cases claimed that a number of renowned companies, including Microsoft, Sun Microsystems, Oracle, Intel, Hewlett-Packard, Cisco and IBM, were their crucial business partners. The relations included not only business trading but also technical support and technological upgrading. In the case of Sparkice, besides China Unicom, it had joined hands with Cybercash, an American IT corporation which specialises in on-line payment systems, to develop e-commerce in China. To create an effective on-line transaction system is a prerequisite to e-commerce. This technological linkage was as important as government linkages for Sparkice.

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[36] Interviewee 27.
[37] Interviewee 1.

To be sure, if a domestic organisation could monopolise some particular resources, albeit not relating to technology, it is easier for it to tempt other companies to form partnerships. As mentioned above, China Telecom as well as China Unicom manipulates almost the entire telecommunications infrastructure. Some companies thus seek to make use of the advantages of these state-owned telecommunications corporations to facilitate their business plans. An Internet company in Beijing among my cases developed an exclusive remote website building solution and formed a partnership with Beijing Telecom (a local subsidiary of China Telecom) to promote the business. Beijing Telecom provided servers and other hardware, while his company provided software and other technical support. Beijing Telecom, with a great number of business outlets, also took charge of securing customers. Both parties then divided the profits according to their agreement.[38]

Enjoying a quasi-official status, China Telecom is also a business-oriented organisation. It is listed on the Hong Kong Stock Market and now actively makes use of its own monopolised resources to diversify its business. Strategically to form business partnerships with other IT firms is more efficient than to internalise new businesses. China Unicom, a young company, has highly depended upon various joint operations or joint ventures to proliferate its businesses in the past few years.

Under marketisation, other state-owned undertakings are also seeking alternative profits by making linkages on their own. As noted above, education software companies have to buy ISBNs from book publishers for their software packages. This is basically a rent-seeking business endowed by the regulatory regime. However, some publishers with foresight have not only simply been rent-seekers but also sought partnerships with

[38] Interviewee 26.

the software developers so as to enter the New Economy. In one of my cases, an education software company created a partnership with the book publisher from which it bought the ISBN. As the publisher had better connections with the state's education system, it could assist the promotion of the products. The publisher also wanted to enter this new market of education software but did not command the technology. The mutual benefits to the two companies facilitated the formation of a partnership.[39]

Two other small software companies also negotiated with publishers for joint projects. One of them was still negotiating with two big university presses to publish books on computer applications. It was going to pick one of the two to be its partner.[40] In another case, a software company specialised in electronic English teaching, and the company intended to combine its own IT technology with a publisher's professional knowledge in English editing to promote a new software package. The interviewed entrepreneur complained that being attached to the state system too long, the attitude of the publisher remained very conservative and that the publisher also claimed too high in the ratio of profit-sharing.[41]

The above cases suggest that profit making and marketisation provide significant incentives for enterprises to combine resources. This synergy is worked out in a business-oriented and competitive manner. Of course, the pre-reform institutions e.g. the state monopoly of book publishing and telecommunications — were shaping the process, but this was path-dependent rather than social embeddedness.

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[39] Interviewee 7.
[40] Interviewee 11.
[41] Interviewee 23.

The last section discussed the difficulty small private firms had in becoming well financed. Most of them heavily rely upon profit retention to accumulate capital for reinvestment. This makes them liable to fall behind other better-financed companies in market competition. In order to speed up their development while constrained by the condition that they are not entitled to bank financing or raising funds from the stock market, some firms seek out other companies to form a joint venture. This can expand the scale of a company in a short time and help partners share experiences.

Many of the IT companies in my sample revealed that they were eager to form such joint ventures. The favourite partners were foreign-funded IT companies, because it is supposed that besides capital, these foreign companies can bring foreign management experience and advanced technology into the joint venture. Moreover, a joint venture with a foreign partner can be re-registered as a Sino-foreign enterprise, which can help build up a better image and enjoy preferential policies. The most important of these is that the joint venture can automatically enjoy an independent right to import and export, and tax exemptions for imports. This can reduce costs when it needs to import foreign equipment. Moreover, the burden of income tax for foreign firms is half that for domestic firms on average.[42] Among my cases, one of the software firms in Guangzhou formed a joint venture with an IT company from Hong Kong which wanted to exploit the mainland market.[43] To be sure, to seek a foreign partner is no easier than to seek bank loans. The negotiations to form a joint venture in the above case took over two years. The domestic companies need to demonstrate qualities that can appeal to the foreign companies. In general, the small private IT firms lack these

[42] *Zhongguo jingying bao* [China Business], 5 September 2000 (Internet edition: www.cb.com.cn).
[43] Interviewee 52.

resources; otherwise, they would have been able to secure venture capital. To form a joint venture with a foreign company is easier said than done for most small private firms.

However, a long-term trading relationship may compensate for other qualities in prompting foreign firms to embark on a joint-venture relationship. The Guangzhou-based PC manufacturer was going to form a joint venture with a Taiwan-based company that had been being a major supplier of its PC components. Long-term business trust was a significant force in this merging. This arrangement would definitely strengthen the market competitiveness of its PCs, which could now purchase cheaper components.

Another source of partnerships is SOEs. Many private enterprises now choose to form joint ventures with SOEs, while government policy encourages the diversification of ownership. However, the IT enterprises among my cases, especially the technology-intensive ones, tended to disparage the SOEs. As in the example of a joint project in electronic English teaching, mentioned above, the private side was critical of the conservative nature of the state publisher. In general, the SOEs present an image of old-fashioned practices, poor performance, cumbersome management, and bureaucratism — not a good match for the New Economy. Let alone seeking a partnership, some of the companies among my cases distanced themselves from the SOEs in business trading. The Guangzhou-based PC manufacturer claimed that his company did not conduct any business with SOEs, though it did with the state administrative organs. He denounced most SOEs as unreliable and claimed that they never kept promises (*bujiang xinyong*).

Despite the above negative factors, the SOEs still hold certain valuable resources. The status of an SOE to a certain extent helps in corporate financing. After forming a joint venture with an SOE, a company tends to find it a little bit easier to obtain loans from banks, as was the experience of an enterprise among non-IT cases that entered into a state-private joint venture.[44] In addition, many SOEs possess idle fixed assets and surplus manual labour that can be otherwise engaged. These resources remain useful for labour-intensive production process. The Beijing-based PC manufacturer was negotiating a joint operation or joint venture with a renowned steel conglomerate in the capital. The "marriage" was initiated and mediated by the municipal Economic and Trade Committee. The interviewee expected that if it was successful, the company could install new assembly lines so that the production capacity could increase multifold, keeping apace with PC giants such as Legend and Founder.[45]

To form a partnership between indigenous private entrepreneurs is the easiest route, but it usually takes the form of absorbing new share capital rather than a joint venture between legal persons. This method was already detailed in Chapter 5. But it does not produce any special synergy as in the case of Sino-foreign and state-private partnerships.

A corporate amalgamation, like other horizontal connections, is dominated by market-driven behaviour and rational business calculations. But the above amalgamations led to unfair competition because of the partially reformed market, as in the privileges enjoyed by the foreign-funded companies. But the entrepreneurs of joint ventures point out that the policy gap that applied to foreign and domestic companies is being narrowed. After China joins the World Trade Organisation, it is believed that both parties should be on an equal footing. Still, the competition will not be absolutely fair.

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[44] Interviewee 25.
[45] Interviewee 1.

Firms with creative strategies and multiple corporate structures are producing different consequences for market competition across the world.

Does Political Capital Matter?

In David Wank's account, political capital is a unique resource for Chinese entrepreneurs to seek to secure the assistance of commercialised bureaucratic power, indispensable to prosper as a private enterprise.[46] "Politicised" public belief always associates the rise and fall of some outstanding enterprises with the fortunes of political leaders who are considered by the public as the patrons of so-and-so enterprises. For example, Zhao Ziyang was associated with Stone Group; the Capital Steel Group (*Shougang*) was supposedly the favourite of Deng Xiaoping. What does political capital mean exactly? How far does such capital matter to the rise of an enterprise?

In the above sections, I touched upon the issue of political capital. For instance, I mentioned the case of a software company that strove to obtain the recommendation of a state agency as an assurance to customers. Indeed, not a few enterprises hoped their products would be recognised by various authorities, as an honour and resource to market their brands. To be sure, this is only a "catalyst" to bridge producers with potential end users. Ultimately, the end users only judge a brand according to the quality of its products. As to IT commodities, the qualitative contrast between the same type of products was relatively distinguishable. The "demand side" analysis counts much more than the "supply side" analysis if we account for the rise and fall of an IT

[46] See David L. Wank, "The Institutional Process of Market Clientelism: Guanxi and Private Business in a South China City," *The China Quarterly*, 147 (September, 1996): 820-38.

business. Customers are better able to choose goods or services. The failure of the estate management software to enter the Beijing market is an example (pp. 177-8).

Of course, consumers or users sometimes are resistant to change. The oft-quoted example is the persistence of the organisation of letters on a typewriter keyboard. A "worse" system may already monopolise the market and users get used to it and have no incentive to switch to another one.

A comparable example can be found among my cases. In the Chinese computer market, Chinese character input is a unique and essential technique for the Chinese computer system. The popular input methods on the mainland now are pinyin and wubi (i.e. five strokes). Among the two methods, the wubi is the most popular and officially promoted. In this method, one needs to press at most five keys to form a Chinese character. A computer engineer in Guangzhou developed a new input method by which the keystrokes for forming a Chinese character are largely reduced. More characters can be formed by pressing only two keystrokes, which enhances input speed. Moreover, it is easier to learn this new method than wubi. However, the engineer failed to popularise this new method. Despite this, the method appealed to a businessman who bought the patent of this invention as well as the engineer's company.

Even though the businessman anticipated good prospects for the software and claimed that the value of this invisible asset amounted to 300 million yuan, the liquidity of the asset depended upon whether he could persuade users to switch to the new method. The businessman adopted various strategies to market the new method and support from the government became an essential "catalyst." The businessman organised a Chinese character input championship by which he wanted to demonstrate his input method was faster than other popular methods. Interestingly, this championship was held primarily in the name of various Guangdong's government departments, including Guangdong's Committee of Science and Technology and the Committee of Education.

The businessman gave me a promotion booklet that contained a couple of photos of government officials accompanied by him. But when I asked him how the government supported his plan of promoting the new method, his reply was not what I supposed it would be — the government only "verbally" supported him. He explained that the government only "took a stance of support" after other people "took a stance of support" and everything was well prepared. The so-called "support" was a posture without any substantial resource input. In other words, he needed to lay a good foundation in advance to convince government officials that everything is okay, that nothing would make them embarrassed or lose "face" when they posed as a supporter. Moreover, the government would be given the credit by assuming the position of the chief host of the activity. The businessman further elaborated his plan:

> "I don't expect any government resource input into my plan. Moreover, I have a policy. Any state agency, school or bank buys my product can pay for the price by yearly instalments. They just pay one quarter of it each instalment. .... My purpose is to support the state. Now the government dispatches civil servants to learn wubi that wastes 2,000 yuan per capita and needs one month to familiarise them with the method. Mine only requires five days."

The core aim of the businessman was to earn big business from the state agencies rather than simply to find a sponsor. But in order to earn contracts from the government, what "capital" he primarily used was an advanced technique and an attractive package, not *guanxi*.

As a norm, many public functions invite a government department to be an "honourable" sponsor as a symbol of legitimacy. But in practice, the departments have no input into the activities, except for officials attending the opening ceremony. If any fault is exposed, though, the officer-in-charge may be implicated, which may account for why the officials are the last to take a stance. The above is not an isolated case. In China, it is not difficult to find the office of some institutions hung with inscriptions from political leaders as a symbol of official support. The political leaders, as a norm, pay visits to some promising enterprises from time to time in a kind of "patriarchal solicitude."[47] However, this does not imply that the entrepreneurs possess political capital, or have a "hard backstage" in advance. The very fact is that the enterprise itself is a "hard backstage," to the point that political leaders are confident of stepping onto the stage. And in exchange the enterprise gains "face" from the honourable attendance of officials.

In fact, increasingly it is the government that cultivates *guanxi* with enterprises. As Victor Nee and Sijin Su have indicated, the business firms are now not only becoming important sources of revenue but also providing a source of investment capital for new business ventures.[48] To re-engineer the state sector, the government hopes that the private sector will participate in the reform of the SOEs. As noted above, the state authority actively initiated and mediated the partnership of the Beijing-based PC manufacturer and an SOE. The government tries to co-opt some well-performing

[47] In China, government leaders always pose as parents of the populace, dubbing themselves "parent functionaries" (*fumuguan*).

[48] Victor Nee & Sijin Su, "Institutions, Social Ties, and Commitment in China's Corporatist Transformation," in John McMillan & Barry Naughton (eds.), *Reforming Asian Socialism: The Growth of Market Institutions* (Ann Arbor: The University of Michigan Press, 1996), 123.

enterprises by according them some honour. Actually, though, political capital accumulates in proportion to the scale and performance of an enterprise. Entrepreneurs do not necessarily put additional effort into gaining this capital. In one of my cases in Beijing, the entrepreneur was recently selected as one of the ten best private entrepreneurs in Haidian.[49] However, the graced entrepreneur did not appreciate it very much, because it was seen as nothing more than an "honour."

Moreover, the "patriarchal solicitude" of the government officials sometimes might not bring benefits. In the section on financing, I mentioned a private company, Giant Group. Its project of building a 70-storey skyscraper directly led to financial difficulties for the company. The Giant Group was a renowned private high-tech company before the mid-1990s. Many top leaders visited the company, including Jiang Zemin, Li Peng and Zhu Rongji. In 1992, the company decided to construct its own building. The first plan was 18 storeys, which was changed to 38 storeys. After a visit by a political leader, who suggested that it should be higher, the management of the company was emboldened to put on 16 more storeys, to 54 and then increased this to 64 storeys, one storey higher than the then tallest building in Guangzhou. In 1994, another leader went to inspect Zhuhai and visited the Giant Group. An idea occurred to the management that "64" was a taboo number.[50] Plans were finalised to build a 70-storey building in order to establish a landmark for Zhuhai.[51] The irrational ambition of the company reinforced by irresponsible official intervention at last drove the company to the brink of bankruptcy, but the government offered nothing to tide it over the crisis.

[49] Interviewee 11.

[50] The number "four" sounds like "death" in Chinese, so it is always considered a taboo. Furthermore, 64 can be associated with June 4 Incident.

[51] *Zhongguo qiyejia* [China Entrepreneur], 149 (September, 1997): 7.

Is the political support a burden or capital? The Guangzhou-based PC manufacturer was catching the attention of the government for its good performance. Government officials also visited the company and showed solicitude for its development. However, the entrepreneur gave his own critique vis-à-vis cultivating *guanxi* with the government:

> "An entrepreneur should pay most attention to his own business and the corporate management. He shouldn't waste energy on 'messy affairs' (*guanxi* cultivation) ... Paying taxes in accordance with the law can make a great contribution to the government. We don't need to strive to secure the government's concern or particular *guanxi* with government leaders. What we should do is to strengthen the management......"

> "We welcome the leaders' visit, but we don't expect any particular solicitude from the government ... I think a spoiled child will never grow up. Even though he does, he must be incapable." (i.e. an enterprise under the patronage of the government cannot become a competitive enterprise.)

Entrepreneurs are alert to the potential crisis caused by unusual political intervention. They know that they are facing a competitive environment that cannot be swayed by the personal authority of officials. What the first priority on the company's agenda should be is to enhance competitiveness in terms of management, technology, productivity and service. Political intervention is a burden rather than political capital. In his case studies of the development of the Capital Steel Group, Edward Steinfeld substantiated that Deng Xiaoping's visit in 1992 to the Group softened the budget constraints of the company, undermining its originally good corporate governance, which at last led to a financial crisis, somewhat like the case of the Giant Group.[52]

[52] Edward S. Steinfeld, *Forging Reform in China: The Fate of State-owned Industry* (Cambridge: Cambridge University Press, 1998), 215-8.

Furthermore, the value of political capital is depreciating. In Chapter 5, I presented two cases of enterprises that moved their headquarters from their initial bases to Guangzhou. The owners of these enterprises had assumed some political or semi-political positions in their places of origin. But these political honours could not override economic factor, and the entrepreneurs did not appreciate the positions. One of the cases was the telecommunications company that moved from Changsha to Guangzhou. When I asked the owner whether he had joined any association of private enterprises in Changsha, he looked as though he had forgotten whether he had. After a second, he refreshed his memory and mentioned that he was a board member of the Hunan Federation of Industry and Commerce and said that it was no more than an honour; he had not participated in the affairs of the Federation.[53] An entrepreneur from Xinjiang had been a deputy to the People's Congress and a member of the People's Political Consultative Conference in Xinjiang. He complained that the positions had no functions, so he was no longer interested in them.[54] I do not argue that entrepreneurs are all indifferent to political positions. It depends upon whether the positions give them a real capacity to exert their influence upon the government, not just an honour. I will further discuss this issue in the next chapter.

Concluding Remarks

The above sections examined the inter-organisational business linkages of the enterprises from five aspects. Combining the five aspects, I find that the on-going transformation of the politico-economic system is so diverse and complicated that

[53] Interviewee 30.
[54] Interviewee 34.

different variables are differently influencing the development of private enterprises. Despite this, five remarkable trends can be identified:

First, the private enterprises in my case studies vigorously participate competitively in the marketplace. The private entrepreneurs have to adopt various strategies and multiple connections to compete with each other. No specific linkages can guarantee the success of an enterprise, though some linkages are more important than others. The linkages with trading parties, regulatory authorities, financial institutions and horizontal collaborators all can account for the rise and fall of an enterprise. Moreover, the bonds of some of these linkages become increasingly loose due to increasingly fierce market competition. Further, linkages are seldom exclusively connected to one enterprise. Contacts are now more accessible to all business entrants. The failure to develop access can be attributed more to the inadequacy of relevant professional resources rather than to the distortions created by artificial personal relationships. This phenomenon has been increasingly evident in the transition from a seller's market to a buyer's market in recent years.

Second, although *guanxi* ties do continue to function, they are not necessarily exchanges embedded in pre-business personal relationships. They become open, competitive and non-exclusive. The traditional *guanxi* tie, which is based upon long-term cultivation of "human feelings" (*ganqing*), may help those business starters who have no market experience, but it becomes ever more costly as businesses develop. Relying upon a traditional *guanxi* tie to build up a business network is time-consuming and leads businesspeople to lose other business opportunities. In addition, the traditional *guanxi* tie becomes less reliable because "money relations" replace "human feelings" during marketisation. When I asked the entrepreneur who took up the business of the Chinese character input how he promoted his products, he replied that he would ask his "friends" to open firms to do the marketing. I asked him what "friends" meant. He said that he would openly recruit somebody to launch the business, and those he recruited were regarded as his "friends." This type of *guanxi* is in no way different from the sociological concept of an "impersonal relationship." I do not argue that there is perfect information in the market that reduces transaction costs so that entrepreneurs can leave all informal ties behind. However, the bonds of informal business ties are ever more based upon the objective performance of business partners. They are so-called "professional ties."

Third, to be sure, the configurations of the linkages vary with different industries. The hardware, software and Internet business are different from one another. The different sectors of the software business also vary from each other. The relationships between trading parties in different marketplaces are not the same. Dyadic, market and government trading produce different configurations of linkages. Indeed, if one highly depends upon dyadic and government trading, certain business linkages become crucial. However, better developed enterprises tend to diversify their trading marketplaces. A company that depends upon only one or two customers is facing a bottleneck in its development. The company that is proficient at budgeting software for the building industry, noted above, had tried to develop other types of software, but was not very successful. As a result, the ratio of its turnover that depended upon the recommendations of a government department was too high. Patron-client relationships did exist in a couple of my cases, but their competitiveness was not thus enhanced if solely relying upon this relationship.

Fourth, the state regulatory regime significantly shapes linkages in the marketplaces. The IT industry is less regulated than many other Chinese industries, yet the strict controls over IP service, encryption software and ISP business prevent the private sector from easy access to these business fields. The monopoly of China Telecom reinforces the dependence on it of certain private IT firms, especially the Internet-related businesses. As a result, customers have to bear the cost of the slow development of the industry caused by a lack of market competition. The Chinese government is aware of the problem and is taking measures to gradually break down the monopoly. The first step is to split up China Telecom into four independent companies.[55] On the other hand, the Chinese government is strengthening regulations over the industry, and further distortions of the marketplace are possible. It is not easy to speculate about the consequences of interactions between marketisation and regulation.

Finally, David Wank expects that clientelism will persist as the economy of China becomes more developed, and he hypothesises that the larger a company becomes, the more significant the patronage of the government becomes. But my finding is that the more developed an enterprise is, the more autonomous the enterprise becomes. Among my cases, the better performing enterprises have better access to various economic resources. As Wank suggests, the large enterprises tend to need more resources monopolised by the state, but the local government sets no obstacle to their

[55] The four independent companies separately embark on the businesses of fixed telephones, mobile telephones, satellites and pagers.

access to these resources and even actively offers the resources to them. Conversely, the smaller enterprises find it difficult to get access to these resources. It must be noted that in spite of the asymmetry of resources between the state and the private sector, the bargaining power of the latter is increasing, especially in the IT industry, upon which the official and semi-official agencies (e.g. China Telecom) increasingly depend to improve their own administrative efficiency and profitability. If the local government fails to provide the private sector with good services, these enterprises are apt to move elsewhere. The larger these enterprises are, the more mobility they are likely to have. In this sense, I prefer to depict the private sector as being in an increasingly good position to take advantage of the "commodification" of the state to co-opt the state agencies, rather than vice versa.

In addition, the weakening of state power means that it sometimes lacks the resources to patronise the private sector. This weakness contains two aspects: fiscal and bureaucratic. The weakness of the state's fiscal resources makes them depend less upon the state's financial institutions and encourage them to seek out other non-state sources. On the other hand, the state financial institutions become freer from political intervention, as now they need to take responsibility for their own profits and losses. Hence, the linkage between the private sector and banks becomes more business-oriented. At the same time, there has been a fragmentation of the bureaucratic system, the thesis put forward by Lieberthal and Lampton.[56] The case of Beijing's venture foundation for the small and medium-sized enterprises is a good example to show that there is a lack of a powerful and unitary bureaucratic system to coordinate policies. Last

[56] Kenneth G. Lieberthal & David M. Lampton (eds.), *Bureaucracy, Politics, and Decision-making in Post-Mao China* (Berkeley: University of California Press, 1992).

but not least, if there are any patrons of China's IT industry, the foreign IT giants are more entitled to that position.

Chapter 7: State-Business Interaction in the Growth of the IT Industry

The foregoing chapter noted that the weakening Chinese state sapped its own strength to patronise the private enterprises among my cases. On the other hand, this also connotes that the state may be unable to energise the private IT enterprises. The failure of the state to finance the small and medium-sized high-tech firms, shown in the last chapter, provides a typical example. However, it can be queried: does state involvement matter? Alternatively, we should ask how far the state is involved in the growth of the sector. In the context of China, where the economic infrastructure is not as well-established as in developed countries, we should further ask whether the Chinese state is establishing a fundamental institution and environment to facilitate IT development. Or is the state itself hindering development? This chapter will try to evaluate how the Chinese state plays a role in steering the development of the IT industry: it first examines other countries' experience, then China's approach in the post-Mao era and finally the findings from my field sites.

Foreign Experiences

Let us discuss first the role of the state in the IT industry in three different cases: the United States, Japan and India. These three cases can be placed on a continuum regarding the degree of state participation. The United States lies on the lowest end, Japan lies at the highest end and India lies intermediate between the two countries.

Silicon Valley in the United States

The United States is the cradle of the electronics industry. Although military spending during the decades around the Second World War was the impetus in spurring the take-off of the infant industry, the growth engine more recently has not been state-led. Silicon Valley, situated at the base of the peninsula south of San Francisco, is now the nucleus of the IT industry in the world. Its origin can be traced to an individual initiation in 1937, by an electrical engineering professor at Stanford University, Frederick Terman, who encouraged his graduate students to open companies to commercialise their research products. Terman also built up collaborative ties between Stanford and local industry to boost the synergy between scientific research and commercial applications. In 1951, Terman pioneered the establishment of the Stanford Industrial Park next to the university to intensify the cooperation between the university and industry. Terman leased the land in the Park to firms at very advantageous terms, on the basis of their excellence in electronic technology and of their close contacts with Stanford. The Stanford Industrial Park later became the model imitated by other technopolises across the world.[1]

Silicon Valley shared in the military bonanza to fuel the first stage of its development. However, compared with another electronics centre in the United States, Boston's Route 128 situated in the old industrial region of the East Coast, which enjoyed proximity to the federal political centre, Washington, Silicon Valley shared less in the pool of military investment than its eastern counterpart. Paradoxically, Silicon Valley thus better survived after the cut in government spending on military research in

[1] Manuel Castells & Peter Hall, *Technopoles of the World: The Making of 21st Century Industrial Complexes* (London: Routledge, 1994), 15-6.

the 1970s and in the crisis of the electronics industry in the 1980s.[2] Silicon Valley has replaced Route 128 in assuming leadership in the industry since the 1990s and in moulding the extraordinary rules of the game for the IT industry.

The success of Silicon Valley is credited to its special corporate culture in the "Wild West." Different from the traditional vertically integrated, closed and autarkic large corporate structure at Route 128, the companies in Silicon Valley tend to be smaller and open to access from other companies, including business rivals. As a result of the frequent job-hopping of specialists and would-be entrepreneurs across the firms in Silicon Valley, entrepreneurs in the region are acquainted with each other. Companies tend to work together as in a community. And based upon this historical context, the relationships between companies are not only those of competitors but also of collaborators. Instead of integrating all production processes into one company and developing a proprietary system, Silicon Valley's firms tend to specialise in one specific area, and to join hands with or rely upon supplies from other firms. The cooperation also includes cross-licensing and second-sourcing agreements. The former entails liberally cross-licensing patents to competitors to quickly diffuse the latest technology. The second-sourcing agreements ensure the existence of alternative suppliers and also help to upgrade the capability of competitive groups of engineers because the arrangement requires that competitors share not only technical specifications but also details of manufacturing processes with competing producers. By the above arrangements, the development cycle of products can be shortened so that the firms can keep a leading edge in their specialised areas.

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[2] AnnaLee Saxeian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128* (Cambridge: Harvard University Press, 1994), 11-27.

Another special characteristic of the firms is their financing. IT start-ups are typically set up by young engineers who have acquired operating experience and technical skills from their working in other firms in the region. When they cannot realise their idea in their current workplace, they draw up a business plan and seek funding and advice from local venture capitalists to set up their own ventures. These venture capitalists are different from traditional bankers. They themselves are often former engineers and entrepreneurs and have concrete experience in the operation of the IT industry, so that they are in harmony with those fresh entrepreneurs. They also frequently participate in the day-to-day operations of the new ventures. Although this special type of financing originated on the East Coast, the West Coast has best exploited its advantages and has turned it into a popular financing channel specifically for the IT and other high-tech industries.

The practices in Silicon Valley break the lines of a traditional business cycle model in which technology tends to be stable over time, so vertical integration and corporate centralisation produce scale economies and market control until another technological breakthrough. The Silicon Valley's model is that business rivals do not resort to defensive measures but compete with each other by incessant innovation on the latest shared technology, adding value to it rather than excluding external access and concentrating on cost-cutting mass production. This special approach, according to AnnaLee Saxenian, is based upon the network-based, informal relationships and blurred boundaries among the firms geared to fostering a vigorous innovative milieu.[3]

[3] Ibid.

The above unique qualities of business institutions in Silicon Valley, including those of cross-licensing, second-sourcing and venture capital, are based upon individual or corporate initiative rather than any functional action of the state. Indeed, in spite of a tremendous resource input into the IT-related defence industry, the US government maintains no industrial policy, even though the threat from Japan intensified from the 1980s onwards.

MITI and the "Catch-up" of Japan

The United States has been the bellwether and standard-setter in electronic technology, but it has been confronted with a foreign challenge — Japan, which has secured the lion's share of the global semiconductor market, overtaking the United States since the 1980s. In contrast to the United States, the post-war economic growth of Japan was marked by a high degree of state involvement — a so-called "developmental state," in Chalmers Johnson's term. Going beyond the "regulatory" function as in the case of the United States, the "developmental state" is engaged in entrepreneurial decision-making for the sake of the national interest and puts decisions into effect through its monopolised power.

In the area of international business competition, Japan's Ministry of International Trade and Industry (MITI) drew much scholarly attention in the 1980s for its pivotal role in directing and supporting the domestic private sector in the international market competition.[4] Founded in 1949, the Ministry is a powerful state machine, exercising a wide range of areas of authority from controlling imports to

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[4] See Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford: Stanford University Press, 1982).

target-setting of industrial development and manipulating capital channels. In the early years after the War, MITI played a very heavy-handed role in nurturing infant industry by setting high tariffs, imposing import quotas, subsidising selected industries, limiting domestic competition and supporting exports. At the same time, Japan also took the advantage of its close ties with the United States to foster an inflow of new technology so as to keep up with the latest technologies. The protectionism kept foreigners out of its large domestic market and Japan's support of free trade abroad proved effective in spurring the swift economic reconstruction of post-War Japan.

In terms of the electronics industry, MITI adopted the same strategy to invigorate the domestic firms. The industry began to take off in the 1960s. Domestic manufacturers were protected from foreign competition by high tariffs. No computer could be imported without an import license from MITI, and foreign investment was controlled as tightly as imports. But Japan did not adopt an autarkic policy to develop its own technology from scratch. It encouraged foreign companies to form joint ventures with Japanese companies so as to acquire and catch up with up-to-date technology quickly. In addition, the government recognised the significance of the demand side, using government procurement to create demand for the domestic products. And substantial amounts of cheap loans were granted to support R&D in the domestic companies.[5] In the 1980s, Japan started to challenge the leading position of the United States. The most remarkable victory was in the semiconductor industry. Since the mid-1980s, the share of Japanese companies in the world chip market has overtaken the United States. During the process of emulation, MITI played a specific role in

[5] Peter Evans, *Embedded Autonomy: State and Industrial Transformation* (Princeton: Princeton University Press, 1995), 100-1.

formulating systematic strategies to target the market strongholds of Silicon Valley one after another.[6]

However, some studies play down the contribution of the government in recent decades in Japan's economic development. Compared with the early success in steel, shipbuilding and sewing, Michael Porter points out that aggressive efforts by the government to develop chemicals and plastics, aerospace, aircraft, and the software industry has largely failed to make Japan an international competitor. In some industries, including computers, the government's attempt to limit competition proved erroneous. It was the unwillingness of firms to abide by government plans that saved the day.[7] In Castells and Hall's study, MITI's plan of setting up 26 technopolises across the country in order to spread industrial hubs into less developed regions has not yet diminished the dominant role of Tokyo and its surrounding regions.[8]

To be sure, after two decades of economic reconstruction, the role of MITI had already shifted from that of direct control to guidance. The sphere of its influence is not as wide as in its early history.[9] Firms occasionally ignored the plans of MITI and relied less upon the resources of the state.[10] The dynamism of fierce domestic rivalry contributed much more to the competitiveness of Japanese firms in the global market.

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[6] Tom Forestor, *Silicon Samurai: How Japan Conquered the World's IT Industry* (Cambridge: Blackwell, 1993), 46.
[7] Michael Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990), 414.
[8] Manuel Castells & Peter Hall, op. cit., 112-43.
[9] Jon Pierre & Sang-Chul Park, "The Dynamics of Abstract and Manifest Institutional Change: MITI and the Japanese 'Economic Miracle' Reconsidered," *Governance* 10, 4 (October, 1997): 351-76.
[10] Fred Warshofsky, *The Chip War: The Battle for the World of Tomorrow* (New York: Scribner, 1989), 120-1.

By contrast, industries in Japan that were over-protected become unproductive and unresponsive to change.[11]

MITI now plays a role in signalling to firms rather than directly intervening in their decision-making. The growth of the IT industry is mainly driven by rapid self-initiated innovation. The degree of government participation in this respect seems limited.[12] In spite of the prolonged economic recession from the early 1990s onwards, the Japanese government realises that what it can do is limited and recognises that private companies acting independently is the key to improving industrial competitiveness. The government can be only confined to playing a supplementary role — modifying regulations.[13]

Some authors credit other factors in their accounts of Japan's success. Tom Foster highlights the higher capability of Japanese firms in commercialising the output from research, while Europe and the United States over-emphasise basic scientific research. As a consequence, when many new basic technologies were invented by Americans, the Japanese usually showed themselves more capable of developing these into lucrative commercial goods. The dominance of Japan's consumer electronics in the global market is credited to this.[14] In her account of the loss of Silicon Valley in the war for the semiconductor market, Saxenian de-emphasises the function of market protection by the Japanese government. Instead, she singles out the unique corporate

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[11] Michael Porter, op. cit., 416 & Scott Walker, "A Tale of Two Tigers and a Giant: Comparing the Response of Japan, Korea, and Taiwan to the Asian Financial Crisis," *Asian Perspective* 24, 2 (2000): 33.

[12] Michael Porter, op. cit., 414-6.

[13] See a recent interview with the Minister of MITI, Kaoru Yosano, in Shige Makino and Mika Shinkai, "MITI Minister Kaoru Yosano on Reviving Japan's Competitive Advantage," *Academy of Management Executive* 13, 4 (November, 1999): 9-11.

[14] Tom Forestor, op. cit.

structure of the Japanese firms, in which suppliers, subcontractors, customers and bankers are informally and closely tied, which permits lower product costs, faster development and more responsiveness to the market. She attributes the failure of Silicon Valley to its resort in manufacturing to a traditional model of mass production that isolated engineering and design from manufacturing.[15] She highlights both Japanese and Silicon Valley's unique networked corporate cultures as an essential condition of success in the New Economy.

No matter how one accounts for the success of the Japanese IT industry, state participation is noticeable. Although MITI now employs a more indirect policy leverage than direct control over supply and demand, it never embraces a belief in market absolutism and broad deregulation.[16] The Ministry might not make all of its economic decisions correctly and it is no longer as powerful as before in policy enforcement, but it did empower certain fledgling industries in the early years so that the domestic firms could directly face foreign challenges in later years. From the viewpoint of neo-statism, a strong state is not equivalent to an omnipotent entity, which takes up every job by itself. The definition of a state's strength also changes over time: it is more important for the developmental state to strengthen the business sector in collaboration with itself on pursuing development goals. This is especially relevant for the late industrialising countries.

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[15] AnnaLee Saxeian, op. cit., 90-1.
[16] Shige Makino and Mika Shinkai, op. cit., 11.

India: a New Software Superpower

India is in the spotlight because the booming Indian IT industry is challenging the conventional wisdom in which poor countries should modernise by first emphasising labour-intensive and low-skill industries, as was the cases of the East Asian countries in the wake of World War II. India's IT industry has skipped this middle stage between agriculture and high technology, directly entering into this knowledge-based industry and becoming one of the top software exporters. During the decade from the mid-1980s to the mid-1990s, the annual growth rate of software exports averaged above 60%.[17] The IT industry boasts the second richest man after Bill Gates, Azim Hashim Premji, the chair of Wipro, the IT giant in India. The outstanding performance in the IT industry is in very sharp contrast to India's poor performance in other sectors.

Influenced by English Fabian socialism, the post-independent Indian political leaders adopted autarkic and semi-socialist economic policies. Despite no mandatory command planning and nationalisation of the private sector, the characteristics of the policies were likened to several that applied in Mao's China: (1) restrictions upon foreign direct investment (FDI); (2) emphasis on heavy industry and state ownership; and (3) discriminatory pricing against agricultural products. Despite the existence of the private sector, its proliferation was controlled by the state's industrial licensing system, i.e. a license-*raj* that resulted in patron-client relationships between state bureaucrats and the privileged business firms.

[17] S. C. Bhatnagar and Shirin Madon, "The Indian Software Industry: Moving towards Maturity," *Journal of Information Technology* 12, 4 (1997): 279.

Likewise, the economic outcome was no better than in China. The poor performance of SOEs was evident. The growth rate of GDP averaged 3.6% from 1950 to 1980, dubbed the "Hindu rate of growth." The growth did speed up to 5.7% in the 1980s, but this was based upon unsustainable macroeconomic policies and led to budget deficits during the 1980s that culminated in the financial crisis of 1990.[18]

More than 10 years after China, India resorted to reforms by opening up India to outside investment and de-licensing firms from 1991. The economic performance in the 1990s seemed to have rid itself of the "Hindu rate of growth," by soaring to around a 7% average annual growth rate over the past half decade, forecast to outstrip China's in 2000, in which the IT sector is a spearhead of growth.[19] Despite the bullishness among Indians, however, India is lagging far behind China in overall performance, not only because of the late start of the reforms but also because of its enduring weak bases in infrastructure, exports, absorbing FDI, the old economic sector (i.e. agriculture and manufacturing) as well as the larger extent of poverty among the population.[20]

Endeavouring to pursue developmental goals after independence, according to Peter Evans, the Indian state was intermediate between the developmental and predatory model. This type of state performs inconsistently but occasionally generates striking success in promoting industrial transformation. Owing to the generalist training of

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[18] Vijay Joshi and I. M. D. Little, "India — Reform on Hold," *Asian Development Review* 15, 2 (1997): 1.

[19] Roger Mitton, "Giant on the Move: from High Technology to the Creative Arts, India is Rapidly Becoming a Global Player," *Asiaweek* 26, 31 (11 August 2000): 30-3.

[20] India has 53% of its population living on less than US$1 a day, compared with 37% in China. See ibid., 31. For comparison of economic reforms and performance between India and China, see Gilbert Etienne, "Economic Reforms in China and India," in Henri-Claude de Bettignies (ed.), *Business Transformation in China* (London; Boston: International Thomson Business Press, 1996); Tapen Sinha and Dipendra Sinha, "A Comparison of Development Prospect in India and China," *Asian Economies* 26, 2 (June, 1997): 5-31; Manmohan Agarwal and Dipankar Sengupta, "Comparing Transition Economies: China and India," *China Report* 36, 1 (Jan.-Mar., 2000): 1-28.

Indian civil servants as well as the lack of networked connections with the private sector, the state bureaucracy was unable to coordinate industrialisation well.[21] Rampant corruption and patronage further exacerbated the dysfunctional role of the state in economic development.

However, the state-business relationship in terms of the IT industry is an exception. In India, the Department of Electronics (DOE), which was formed in the early 1970s, has taken charge of IT policy. According to Peter Evans, the DOE is an industry-friendly government department, technology-oriented and more immune to corruption. From the early 1970s to the mid-1980s, the state stuck to import-substitution, self-reliance and a state-ownership centred approach to the electronics industry that turned around the situation of foreign sector dominance over the industry in the 1960s. Although the strategy helped to nurture an indigenous sector by keeping it away from foreign competition, the sector was unable to keep pace with up-to-date technology.[22]

In 1984, the new energetic Prime Minister, Rajiv Gandhi, launched the first but ephemeral reform. The state liberalised the entry of private capital and imports in the IT industry, allowed the formation of joint ventures and switched to an export orientation. The DOE immediately unloaded the past policy legacy and shifted energetically to the new line. This flexibility should be credited to the fact that the DOE did not bear the burden of representing a significant political constituency or of providing patronage

[21] Peter Evans, op. cit., 45 & 69.

[22] Hans-Peter Brunner, *Closing the Technology Gap: Technological Change in India's Computer Industry* (New Delhi: Sage Publications, 1995), 66-93.

jobs, as in other sectors.[23] The growth of the IT industry was further spurred by the full-fledged liberalisation from 1991 onward.

The DOE is not as highly involved in business planning as the MITI. It is more a facilitator rather than a heavy-handed bureaucratic entrepreneur. It should be noted that the strength of IT industry in India is not in electronics manufacturing but software engineering and design, and teleworking. And this direction in development was not a premeditated and deliberate plan of the government. It just happened to match the global trend of an international division of labour in the IT industry. Many American and European companies sought cheaper offshore services since the end of the 1970s because of rising domestic labour costs. Because the infrastructure of India is poorly developed, including in transportation, power supplies and other bases for manufacturing industries, It has failed to imitate the East Asian countries' history of first taking an international position in labour-intensive industries. Even though the IT firms in India have engaged in hardware manufacturing, the performance of the software counterpart puts this in the shade.

With the advantage of its huge pool of well-educated English-speaking scientists and technicians, plus the frequently remarked upon mathematical abilities of Indians, India has an overwhelming edge in serving the English-dominated software industry. Indian engineers and programmers of high quality can be hired at a fraction of the wages of their Western counterparts. With the Western world expecting a wide gap between the supply and demand of IT engineers in coming years, and with the top European offshore service provider, Ireland, also experiencing tight labour market, Indian IT companies became the greatest beneficiary. They were well set to catch the

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[23]Peter Evans, op. cit., 113-5.

flood of offshore jobs. By contrast, Japan never obtained these intrinsic advantages and so it failed to take an international position in the software industry.

It is ironic that even now the degree of penetration of computers among the Indian population remains low and the telephone network is poorly developed. Hence, the domestic market has not significantly supported the Indian IT industry, albeit it has been rapidly growing since the early 1990s.[24] Software exports and service exports were the major impetus to the burgeoning IT industry.[25] By the same token, both FDI and well-educated expatriate Indians who studied computer engineering in the United States and moved their careers back to their home country helped to sow the seeds of the development.

Bangalore, the capital of the South Indian state of Karnataka and situated on a cool plateau above the hot Indian plain, is now dubbed India's Silicon Valley and contributed almost a third of Indian software-export sales in 1999.[26] More than 1,600 multinational and homegrown computer firms now congregate in Bangalore. The rise of Bangalore as the base of the Indian IT industry owes to its historical background as the technological metropolis of India. The central government invested lavishly in the building of Bangalore's civilian science and technology infrastructure as well as the nation's most sensitive and advanced military and space research facilities.[27]

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[24] S. C. Bhatnagar and Shirin Madon, op. cit., 284.

[25] During the financial year 1999-2000 (March-February), the Indian software industry grossed 5.57 billion US dollars in which the export accounted for 4 billion. See Dewang Mehta, "Indian Software for the E-age," *Forbes Global* 3, 24 (27 November 2000): 118.

[26] Ambika Pathi, "Silicon Valley of the East: Bangalore's Boom," *Harvard International Review* 21, 4 (Fall, 1999): 8.

[27] John Stremlau, "Dateline Bangalore: Third World Technopolis," *Foreign Policy*, 102 (Spring, 1996): 152-68.

However, US companies initially chose Bombay and New Delhi to launch their offshore software ventures, as they were the most convenient locations, with their international airports and direct data communication links. A breakthrough occurred when a high-ranking Indian-born scientist working for Texas Instruments championed the offshore facilities in Bangalore because of his association with his alma mater, the Indian Institute of Science in Bangalore. However, there was a lack of telecommunications infrastructure in Bangalore to build up an offshore software development centre, but the government was very responsive to this issue. The DOE stepped in to address the constraint by setting up a direct satellite link between Texas Instruments' facilities in Bangalore and those in the United States. The government's responsiveness gave a positive signal to other IT companies, luring them into Bangalore, including Digital, Hewlett-Packard and Motorola.[28] Other cities followed suit. Alongside the flocking of multinational companies to India, new indigenous private firms thrived in the 1980-90s. These start-ups were allowed to tap financial resources on the stock market, rapidly grew within a decade, and now already account for the lion's share of software exports.[29]

It is very critical that the satellite link helps to bypass other constraints caused by the inadequate infrastructure. Given the special nature of the software industry, which is not dependent upon the supply of components for processing, plus the entrepreneurs' eased access to imported hardware under the liberalised trade policy, the

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[28] Vikas Deshmukh, "Bangalore: India's Hi-tech Birthplace," *Economic Reform Today*, 3 (1993) (www.cipe.org/ert/e09/india-3.html).

[29] S. C. Bhatnagar and Shirin Madon, op. cit., 283 and Anthony P. D'Costa, "Capitalist Maturity and Corporate Response to Economic Liberalization in India: the Steel, Auto, and Software Sectors," *Contemporary South Asia* 9, 2 (July, 2000): 154-7.

IT sector is largely insulated from surrounding deterrent factors. Further insulation is realised by the establishment of technopolises. Under the auspices of the Software Technology Park Scheme of 1990, many technology parks have been built up on the outskirts of cities that help to insulate the IT sector from the cluster of congested old urban areas. These parks are self-contained hi-tech communities, which have their own power, sewage, satellite communication systems and offer health care, schools, housing and other facilities for daily life. In addition, software companies also enjoy various preferential policies, including tax exemptions and tax holidays, and cheap land offerings.

This "greenhouse" arrangement is widely adopted in developing countries to boost this newborn sector. The implication of this arrangement not only provides such an innovative milieu as in Silicon Valley, but also a high-tech haven to harbour the new economic powerhouse sector from red tape and corrupt institutions. This may be the best approach for the "intermediate" state to catapult itself to the forefront of the global economy because it is time-consuming for a weak state to wait for the turn around of the entire institution.

To be sure, the "greenhouse" cannot be completely isolated from the outside world. The Indian IT sector has been plagued by an inadequate infrastructure. Constant power outages prevent effective communications and computer work. And it still takes much time to travel between software parks and downtown Bangalore due to the poor transportation infrastructure. The public IT agencies still enjoy preferential access to government projects that stifles competition and the formation of a more vigorous domestic market.[30] The new sector is not completely immune to the ailing old sector, and it is apparent that the new sector is facing bottlenecks in its development caused by the inefficiency of the old sector. But this very fact provides incentives for the government to reform the old sector and other related institutions. Alongside the liberalisation from 1991 onward, the government has unleashed an entrepreneurial spirit by pruning its socialist roots and resorting to privatisation. More importantly, many cities, including Hyderabad, Chennal and Pune, are trying to catch up with Bangalore in the IT industry. The overcrowded environment and rising business costs in Bangalore have apparently channelled some capital into those cities. The inter-city competition also creates incentives for local governments to hasten reforms in order to gain a cutting-edge position over rivals.

What lesson do the three countries give us in terms of the state-business relationship in IT industrial development? The three cases share the common experience that a vigorous private business environment is indispensable for the growth of the IT industry. And only the private sector has the underlying substance to gear up for the development drive, even though this varies from one country to another. As Porter remarks, the private firm and not the government creates and sustains an industrial competitive advantage.[31] But one still needs to ignite these private resources and to add the catalyst to drive them forward. The state can play this role. Although the role of the state in the US looks insignificant, there was no doubt that the American government already had laid a good foundation of economic institutions and entrepreneurship was

[30] S. C. Bhatnagar and Shirin Madon, op. cit., 287.
[31] Michael Porter, op. cit., 619.

thriving far ahead of the emergence of the industry. Moreover, the government's military spending in the early years gave the first momentum to the business.

For the latecomers, the state's role is more significant. The latecomer countries tend to be weak in their economic foundations. In order to catch up with the advanced countries quickly, the state needs to do more than just play the role of a "custodian." Japan lay within this historical context. But Japan is a "strong state" model; another latecomer, India, is weaker than Japan, as an intermediate state. The intermediate state fails to penetrate effectively into every aspect of society. It can only make an effort to develop a partial reform in the field with less social and political resistance first and selectively empower a specific group within the economy. Taking advantage of the success of the partial reform, the state then spread the momentum into other sectors of the economy. China is sharing in the same strategy.

The case of India is comparable to China in many aspects. Both countries have a background of a state-centred approach in development. Both have a huge population and share the same problems of poverty and of disparities in wealth distribution. Despite the time lag in adopting whole-hearted reforms, India launched its reform in technology industry at about the same time as China. The strength of both countries also lies in software technology. Nevertheless, China's performance in the IT industry falls behind India's. In the course of a few years, the industry in India has produced a number of internationally competitive private IT firms. But there is almost none in China today. What is the reason?

China's Approach

To be sure, the contexts of the reforms in China and India are not the same. India is not a socialist country *per se*, albeit it adopted certain semi-socialist policies. The Indian economic reforms from the mid-1980s onwards are only strategic adjustments accomplished by modulating policy leverage. But China has carried out an underlying structural transformation of the state and economy. And it should be noted that the Chinese state at the beginning of the reforms directly controlled most of the resources of the country. When the state adopted a gradual approach to the reforms, it took considerable time for the private sector to emerge and to accumulate its own capital and to simultaneously struggle with the legacy of the socialist system.

By contrast, India did not start from scratch. There was an established private business class before the liberalisation policy. Wipro, for instance, did not grow from an IT start-up but was an old enterprise producing cooking oils that had already moved to explore the IT business area in the early 1980s. In addition, since the end of the 1960s, the Indian government has formulated specific industrial policies for the electronics industry in which it maintains a strategy of compensating through software exports for the cost of the import of hardware and electronics items.[32] Hence, India is an old hand in the software industry. More importantly, there had already been a large pool of turnkey US-trained IT talents available to India while the state was gearing up the IT engine. These returnees not only financed the Indian IT sector but also transplanted management techniques from the United States that markedly differed from the

[32] Richard Heeks, *India's Software Industry: State Policy, Liberalisation and Industrial Development* (New Delhi: Sage Publications, 1996), 53.

traditional indigenous business sector.[33] In the meantime, Chinese mainlanders first began to obtain a chance to go abroad to learn advanced Western technologies. Entrepreneurship, having been extinguished for three decades, budded at about that time. Most of the current leading IT firms were commercial businesses that provided non-demanding technical services in the 1980s. Under these circumstances, the social base for developing IT industry in China was relatively weaker than that in India in the 1980s.

The Chinese approach to high-tech industrial development, including the IT industry, differed from the three countries' exemplified above in the sense that the latter to a larger extent relied upon an existing private sector, while a well-defined private sector in China was absent in the 1980s. On the other hand, China's approach to a certain extent resembles the US approach in the sense that both rely upon the synergy between industry and universities and research institutes to bolster the industrialisation of high-tech research output. In this regard, in China the universities and research institutes (U&RIs) play a bigger role in nurturing entrepreneurship, and many currently well-known IT companies have spun off from U&RIs.

The spin-offs can be reduced to two types of enterprises. The first are subsidiary economic entities of U&RIs. The typical examples include Legend, a spin-off from CAS, and Founder, a spin-off from Peking University. Another type of spin-offs is separately organised by scientific and technical personnel from the U&RIs. A typical case is Stone. The origin of the spin-offs can be traced back to as early as 1980, when such an entity was firstly founded in Beijing by a research fellow at the Institute of

[33] V.N. Balasubramanyam and Ahalya Balasubramanyam, "International Trade in Services: The Case of India's Computer Software," *The World Economy* 20, 6 (September, 1997): 836.

Physics of CAS, Chen Chunxian, after his tour of Silicon Valley. In 1984, the number of these entities reached about 40 in Zhongguancun.[34] But their legitimacy had not been officially endorsed until 1985 where the government launched the reform of the management system of science and technology.

The 1985 reform intended to re-orient the development of science and technology (S&T) towards economic construction. Under this new direction, the U&RIs were pushed to shift to commercialise and industrialise their research and to engage more in entrepreneurial activities. To be sure, the government at the outset was more oriented towards merging U&RIs into existing enterprises. However, this attempt yielded no satisfactory results because of a lack of incentives or an ability by the enterprises to absorb the U&RIs.[35] By contrast, the performance of spin-offs was more remarkable and drew the attention of state leaders in the second half of the 1980s, especially the fruitful development of spin-offs congregated around Zhongguancun, which induced the government to explore the advantages of this spontaneous development.

The Torch Programme and New & High Technology Development Zones

China's catch-up plan in S&T was launched in 1986 by the so-called "March 1986 Programme."[36] The aim of it was to rapidly narrow the gap between China and the advanced countries in S&T by strategically sponsoring the research of selected fields of

[34] Ricky Tung, "The Chungkuantsun New Technology Development Zone: Mainland China's Silicon Valley," *Issues and Studies* 24, 2 (December, 1988): 50.

[35] Shulin Gu, *China's Industrial Technology: Market Reform and Organizational Change* (London: Routledge, 1999), 29-32.

[36] This high-tech development programme was named "March 1986," because the proposal was submitted and endorsed by Deng Xiaoping in March 1986.

S&T and to pave the way for the formation of China's high-tech industry. But the March Programme is only concerned with the mid- and long-term goal of S&T development, and it is not concerned with the industrialisation of research output. In order to spur the formation of high-tech industry, the government launched the "Torch Programme" in August 1988. Given the experience of Zhongguancun and Silicon Valley, the government picked the development path of sponsoring the establishment of separate New & High Technology Development Zones (NHTDZs), in urban knowledge-intensive areas like Zhongguancun to tap local resources to develop and disseminate high-tech applications.

By the same token, the Torch Programme does not directly fund the development of high-tech industry and only provides indirect guidance plans to enterprises. It is different from the March Programme in which enterprises and research institutes are directly funded by state appropriations as a mandatory plan. The initiative of enterprises plays a more important role under the Torch Programme. The enterprises in the NHTDZs can secure some competitive small funds or have access to low-interest loans by applying for being project takers of the Torch Programme. The orientation of the Torch Programme denotes a retreat of the state from the direct management of high-tech industrial development. First, the input of state resources into R&D has diminished since the reform era. This is in line with the thrust of S&T policy, which intends to marketise the institution of S&T. Enterprises are encouraged to explore alternative channels to finance themselves. The state just requires banks to set up a loan quota earmarked for high-tech industries.

Second, the state would rather draw on preferential policies than input its own resources to foster the high-tech sector. In the NHTDZs, enterprises can enjoy various tax holidays, tax reductions and tax exemptions, and have less restricted access to imports. But the special treatment is less favourable than that applied to Special Economic Zones (SEZs) and Economic and Technological Development Zones (ETDZs). The central government also provides less capital investment to the NHTDZs.[37]

Unlike the SEZs and ETDZs, indigenous private enterprises was allowed to enter the NHTDZs from the outset. That was congruent with the simultaneous legalisation of private enterprises in 1988. However, there were few enterprises registered as "private" in the development zones at the beginning. While the spin-offs formed as subsidiaries of U&RIs were registered as state-owned enterprises, the individually founded spin-offs tended to register themselves as collective enterprises and attached themselves to a supervising unit (*guakao danwei*). To be sure, private enterprises were not treated on a par with the other types of ownership in policy implementation. For instance, the Ufsoft Group was a registered private enterprise in Beijing's NHTDZs from its inception, but it could not enjoy any preferential treatment in its early years because of its private ownership.[38]

No matter what type of ownership was registered, these spin-offs were encapsulated as *minban* (i.e. people-managed) technology-based enterprises in the 1980s and are now known as *minying* technology-based enterprises (The meanings of

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[37] Shuguang Wang, Yulin Wu & Yujiang Li, "Development of Technopoles in China," *Asia Pacific Viewpoint* 39, 3 (December, 1998): 286-7.

[38] *Zhonghua gongshang shibao* [China Business Times], 15 April 1992: 8.

minban and *minying* are more or less the same in Chinese). As noted in the previous chapters, they are distinct from the traditional SOEs in the sense that they receive no funds from the state budget and have independent management. These non-state enterprises are sometimes confused with other generic private enterprises by foreign observers,[39] but their property rights have been ill-defined.

The indeterminate property rights obviously became a hindrance in the later stages of enterprise development. As an entrepreneur of a collective enterprise in Zhongguancun complained to me, "the enterprises in Zhongguancun tend to have a short life span, because the problems caused by being 'collective' have never been well settled. So-called collective enterprises that have made money don't want to further develop, as the expanded collectives do not belong to the real owners."[40] Of course, the same problem was pertinent to the state-owned *minying* enterprises. To alleviate the problem, the implementation of shareholding transformation had already started from 1992 onward. But the progress of privatisation moved slowly. In 1995, among all domestic high-tech enterprises in the NHTDZs, only 6% were registered as private and 17% as shareholding enterprises.[41] In 1998, the ratio rose to 17% and 36%.[42]

Despite the persistence of property rights problems, it was also evident that these non-state enterprises contributed markedly to the technical renovation of the industry and yielded a better performance in market competition. Whereas the state allocated scarce funds to the large and medium-sized state enterprises to renovate their

[39] For example, Ricky Tung put all these spin-offs into the category of private enterprises. See Ricky Tung, op. cit.
[40] Interviewee 19.
[41] Shuguang Wang, Yulin Wu & Yujiang Li, op. cit., 290.
[42] *Zhonghua gongshang shibao* [China Business Times], 12 August, 1999: 1.

technology, the performance of non-state enterprises outdid the state enterprises in technological advancement.[43] In other words, the state wasted a good deal of financial resources that could have been better allocated to the more efficient non-state sector. Due to the absence of intervention from senior authorities, the non-state enterprises are better able to make decisions and react to market signals quickly.

It does not follow, though, that the state contributes nothing to the growth of high-tech industry. Besides the preferential policies mentioned above, the establishment of the NHTDZs created a "greenhouse" for nurturing high-tech industry. In the first place, the NHTDZs set up Service Centres for Scientific and Technical Entrepreneurs as "incubators" to provide venues, facilities, related services, training and consulting guidance for technological innovation activities to protect the high-tech start-ups, especially those initiated by individuals. By 1998, the incubators had reportedly cultivated 3,700 new-type small enterprises, of which 1,200 were high-tech enterprises.[44]

There are now 53 national level NHTDZs established across the country, in every province except Ningxia, Qinghai and Tibet. Each NHTDZ is managed by an elaborate Administrative Commission. It is like a mini-government equipped with almost a complete government apparatus. Its power ranges from admitting enterprises into the zone to planning and financing construction of infrastructure, leasing land, collecting taxes, and dealing with foreign trade and cooperation for its constituent enterprises. To a certain extent, it provides an insulated environment from the

[43] Xiaojuan Jiang, "Chinese Government Policy towards Science and Technology and its Influence on the Technical Development of Industrial Enterprises," in Charles Feinstein & Christopher Howe (eds.), *Chinese Technology in 1990s* (Cheltenham: Edward Elgar, 1997), 145-8.

[44] *Beijing Review* 42, 40 (4 October 1999): 14.

inefficient and corrupt old bureaucratic system, much like the Technology Park in India. In the special context of China, the Administrative Commission undertakes one more meaningful function. It can play the part of a *danwei* to provide private firms with a one-stop service, while private firms outside the NHTDZs need to deal with a variety of government departments for just one matter and sometimes find no channel to settle some issues because of the absence of a leading *danwei*.

Different from most technology parks across the world, the NHTDZs — the Chinese technopolises — are not necessarily located in newly-developed suburban districts. Some of them lie in the built-up part of cities where U&RIs cluster. The zone in Zhongguancun is interspersed with other enterprises in a non-NHTDZ urban setting. Hence, the R&D milieu in Zhongguancun is not very favourable compared with the newly-developed zones where the planning and infrastructure are better. For example, the Shangdi Information Industry Base, situated to the north of Zhongguancun, is a newly-developed zone where high-tech enterprises are provided with more space to expand.

In line with the March Programme, the Torch Programme only selects certain kinds of technology as focal points for development, covering 11 fields, including microelectronics and electronic information technology. From the mid-1990s onwards, it further zeroed in on the software industry and separately set up Software Technology Parks to bolster the industrialisation of software technology. Those enterprises engaged in software technology can enjoy extra preferential treatment from the state. Recently, the state further promulgated a new tax policy for the software sector. Firms which sell self-developed computer software are qualified for a rebate of a value-added tax (VAT) so that the real burden can be reduced from the ordinary rate of 17% down to 3%.[45]

To be sure, the state does not put a premium on all types of software. Only those related to the enhancement of productivity and those types of software that are considered critical to the economy are covered. For example, software technologies ranging from finance to management, education and CAD/CAM are put at a premium, while software games are not covered. Likewise, not all enterprises that are engaged in developing "critical" types of software can win favour with the state. The state adopts a "pick-the-winner" approach to selectively cultivate certain enterprises with better performance as the base for global competition. The "pick-the-winner" approach apparently reinforces the effects of business competition. Other conditions being equal, the winners can gain greater resources so that the losers and the latecomers are put at a disadvantage. But it should be noted that the non-state/private sector has not lost its leading position to the state sector, even though they did not won the state's favour at the very beginning. Ever more private "winners" have been picked by the state from the 1990s onward. Ufsoft, CSC and Suntek are now "backbone" enterprises under the Torch Programme. They can secure resources more easily than other firms. For instance, Ufsoft and CSC gained the state's help in land appropriations to build up their headquarters at the Shangdi Information Industry Base (See Plates 7.1 & 7.2).

To be sure, the IT sector remains a fledgling industry. Even though there are some relatively large companies, their strength lags far behind their multinational counterparts. These large companies still operate in an unstable and less

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[45] See Article 5 of "Detailed Rules on Development Policies of Encouraging Software and Integrated Circuit Industry" issued in October 2000.

institutionalised market. Nevertheless, due to the retreat of the state, the resources that can be offered by the state have become less critical; otherwise, they should have been squeezed out by the privileged state sector.

Both the Indian and Chinese states play the role of "midwifery" in fostering the growth of the IT industry. However, the Chinese "socialist" state works at a disadvantage by virtue of its own residual ideological constraints and outmoded economic institutions. It has to expand a much greater effort to demolish the old institutions and to re-build new ones. Both states do not directly input many resources into the IT sector, but the Indian state was better able to channel external resources into the sector. Apparently, a good financial service is one of the most critical factors to boost the sector. While the Indian IT start-ups could raise funds from the public at an earlier time, the Chinese counterparts still cannot find a means to enter the domestic securities market. To enter a foreign stock market requires that a firm either contravene or detour numerous bureaucratic hurdles. The second-board market is still on the way to being established. The lack of channels to go public also discourages the inflow of foreign venture capital, because the stock market is the most desirable outlet for venture capitalists to withdraw their capital from mature start-ups.

In addition, while the Indian software industry can rely upon exports to spur its growth, the Chinese IT industry needs to lean on the domestic market as the pillar of growth, even though the government is spurring an export drive now.[46] Hence, the Chinese government has to make a double effort to nurture the domestic market.

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[46] During the financial year 1998-99 (March-February) software exports from India were worth 2.69 billion US dollars, compared with 130 million US dollars for China in 1999. See the figures from www.webindia.com/india/computers.htm and *New China News Agency* (15 October 2000) (www.china.org.cn/english/2790.htm)

However, this is not easy, especially since the rampant piracy problem in China not only hurts imported software products but also now hinders the growth of the domestic software industry.[47] Accordingly, the sales of the software sector are now only equivalent to one-fifth that of the hardware sector.[48]

The Interaction of Enterprises with the State

The above section has examined the macro policy context of the IT as well as the overall high-tech industry in China. But what is the reality of implementation? This section will explore the experience of the enterprises in my case studies and the multi-dimensional interactions between the state and these private enterprises. These interactions are grouped into three broad dimensions: preferential treatment, tax and fee management, and state-enterprise coordination. The distinctions between my Beijing and Guangzhou cases will be drawn in this analysis.

Preferential Treatment

Less than half of the surveyed enterprises were registered in the NHTDZs: 14 from Beijing and 4 from Guangzhou. In addition, two cases in Guangzhou were located at the Entrepreneur Park, an incubator in the Guangzhou Economic and Technology Development Zone (GETDZ), one of the ETDZs. The establishment of the Park is aimed to tempt overseas Chinese to start high-tech businesses in Guangzhou. And all start-ups can use the offices there free of charge for two years. Owing to it being a

[47] According to a survey done by the Ministry of Information Technology, 26% of respondents of software companies listed piracy as the top threat to their survival. See *South China Morning Post*, 31 August 2000 (Internet edition: www.scmp.com).
[48] *Business Weekly*, 16 January 2001 (Internet edition: www.chinadaily.com.cn).

newly-established incubator, the entrepreneurs in the two cases observed that the GETDZ had thus far granted no further concrete support measures to them.

It should be noted that more of the firms in Beijing lay within a NHTDZ. This was because of the contextual difference between Beijing's and Guangzhou's NHTDZ. Beijing's Experimental Zone for New Technology Industry (hereafter, Experimental Zone) was the first NHTDZ established, in May 1988, right before the promulgation of the Torch Programme. At the beginning, the Experimental Zone was limited to a small area around Zhongguancun (the Shangdi Information Industry Base not yet established), a built-up area where many of the electronics-related enterprises had already congregated before the establishment of the Experimental Zone. As a result, the administrative control was difficult. As the earliest NHTDZ as well as a pilot implementation, the benchmark for admitting an enterprise was neither very high nor standardised. Among the enterprises registered in the Experimental Zone, some of them had just embarked upon business and were merely in IT sales, not technological research.

It should be clarified that to be a member of the NHTDZ is not equivalent to being a "high-tech" enterprise. There is a separate procedure to licence an officially recognised high-tech enterprise. And the licensed high-tech enterprises can enjoy extra preferential treatment and gain more state support. For example, they can apply to undertake projects for the Torch Programme. Besides the three largest private enterprises among my cases, a couple of the medium-sized enterprises in my sample were project takers of the Torch Programme.

By contrast, Guangzhou's NHTDZ, Tianhe Scientech Park (TSP), established in 1991, is located in a new development district, Tianhe. It is a distinct area, separate from other urban settings. Enterprises of the TSP operate in an enclave completely under the jurisdiction of its Administrative Committee. But the Experimental Zone in Beijing overlaps Haidian District. The offices of technology-based enterprises share the same overcrowded area with other types of enterprises. The technological level of the enterprises among the cases in the TSP was higher than that in the Experimental Zone on average. This does not imply that the technological level of high-tech firms in Guangzhou is higher, but only that the admission criteria of the TSP are more stringent and elite-oriented.

By the same token, the enterprises/TSP tie is closer than in the Experimental Zone. An entrepreneur who belonged to the first flock of members in the Zone complained that the bureaucratic structure of the Experimental Zone became increasingly bloated and the bureaucracy itself was too much intertwined with its own economic interests.[49] In addition, while some of the interviewed entrepreneurs in the Zone were able to have access to the government's extra services,[50] others found themselves disregarded by the Administrative Committee. But the latter were conscious that there were too many enterprises in the Zone, and the Administrative Committee was unable to take care of all of them. They anticipated that once they grew up, they might draw the government's attention. Indeed, there are over 4,500 enterprises registered in the Experimental Zone, while no more than 1,000 are in the TSP. The TSP

[49] Interviewee 19.

[50] The extra service included information supply, coordinating companies and assisting corporate financing.

apparently bears a lighter burden than the Experimental Zone and thus has a more favourable business-environment framework, leaving aside the extraordinary human resources in Haidian.

In principle, enterprises in various NHTDZs should enjoy more or less the same preferential policies. This is a central policy aimed at avoiding a vicious competition among the NHTDZs.[51] In practice, there are variations between the NHTDZs in Beijing and Guangzhou. As the earliest NHTDZ, the Experimental Zone has been implementing the preferential policies promulgated by the municipal government with the State Council's approval since May 1988, even after nation-wide policies were issued in 1991. The oft-quoted policy granted in the Experimental Zone is a three-year income-tax holiday for newly-established firms and a tax reduction by half for another three years.[52] This treatment is absent in the nation-wide applied policies, including those in the TSP. But some of the surveyed entrepreneurs considered the first three-year tax holiday provided no benefit to them, because they yielded no profits in the first few years. So, regardless, they did not need to pay income tax at all, no matter whether there was a tax holiday. However, some of the entrepreneurs that were concurrently engaged in a trading business still appreciated the tax holiday. It should be clarified that even though one is not a licensed high-tech enterprise, a firm can also enjoy the tax holiday and reduction as long as it is registered in the Experimental Zone.

In the nation-wide policies, a two-year exemption of income tax takes effect once the high-tech firms have made a profit. This makes more sense for most high-tech

[51] Shuguang Wang, Yulin Wu & Yujiang Li, op. cit., 289.
[52] See *Beijingshi xinjishu chanye kaifa shiyanqu zhengce wenjian huibian* [Collection of Policy Documents concerning the Beijing's New Technology Development Zone] (January, 1999): 3.

start-ups. Besides the tax holiday, the high-tech firms can enjoy a variety of preferential treatments. They pay a lower rate of income tax of 15%, compared with 33% for ordinary firms. They are exempted from a construction tax when they build a new plant or offices. They are also exempted from tariffs when they export their products. In addition, local governments formulate extra preferential policies in order to compete with other places. In Guangzhou, the TSP offers a tax rebate by returning 25% of the local share of VAT back to the high-tech firms. To clarify, this practice is in breach of the central policy. In January 2000, the State Council issued a notification to local governments to stop this practice.[53]

In parallel with other aspects of its reforms, Guangzhou also took new steps ahead of other places, while Beijing tends to comply with the central policy. For instance, in the high-tech industry, intellectual property is considered invisible capital for an enterprise. The Chinese government also allows scientists and technicians to quantify and convert their research products into the registered capital of enterprises, but the maximum ratio of this type of invisible capital could only constitute up to 20% of total registered capital of an enterprise according to the 1993 Company Law. In March 1999, the central government relaxed the restriction by pulling the ceiling up to 35%. In the wake of this, the Beijing authorities followed suit to promulgate parallel local regulations to boost the high-tech industry. However, the Guangdong government had pulled the ceiling up to 30% as early as 1994.[54] In order to absorb more Chinese

[53] See "State Council's Notification concerning Correcting Arbitrarily Formulating Return-after-Tax Policy in Localities" (State Council's Document [2000] No. 2) (11 January 2000).

[54] See Article 7 of "Regulations on Guangdong *Minying* Science and Technology Enterprises" (approved by the Standing Committee of Guangdong People's Congress on 18 January 1994), quoted from the appendix of Huang Renxing et al. (eds.), *Guangdong feigong jingji yanjiu baogao* [Research Report on Non-public Economy in Guangdong] (Guangzhou: jinan daxue chubanshe, 1999), 244.

who have gone overseas to open start-ups in Guangzhou, the municipal government has further opened up the ceiling for these returnee-founded start-ups, limiting no maximum ratio for the convertibility of research products into registered capital.[55]

In my field studies, most of the cases, especially in Guangzhou, were small firms that were not registered in these greenhouse-like development zones. Hence, in general they could not enjoy any preferential treatment. In view of the policy's lean towards the IT industry, some of these small entrepreneurs were toying with moving into the NHTDZ. However, some surmised that their enterprises probably would fail to fulfil the conditions for entry. It should be noted that the entrepreneurs had not obtained sufficient information about the government's preferential policies and so did not know how to obtain the benefits of preferential programmes.[56] More importantly, with regard to the advice given by informants, a couple of entrepreneurs were convinced that it was difficult to obtain the benefits without resorting to *guanxi* practice, and they figured out that the cost of obtaining this benefit might be higher than the benefit itself. Hence, they would rather put more effort into improving their own management and enhance productivity than waste time and money in cultivating *guanxi*.

Their accusation was not well substantiated. Those entrepreneurs who operated high-tech businesses in the NHTDZ reflected that they did not appeal to any particularism. The types of their technologies were supported by the state high-tech policy. No matter what really happened behind the scene, it is interesting to note that when entrepreneurs appealed to the market for business information, personal

[55] *Yangcheng wanbao* [Yangcheng Evening News], 30 October 1999 (Internet edition: www.ycwb.com.cn).
[56] I share this comment with Xiaojuan Jiang, op. cit., 146.

connections remained their source for government information. They did not know or care how the formal documents were written, they just believed what their confidants told them. But were they reliable sources?

Among the firms not in the NHTDZ and ETDZ, only one had access to preferential treatment. It was a small firm in Guangzhou. The Guangzhou government is now encouraging the development of software industry and has provided preferential treatment to software companies provided that they are deemed technology-based companies, even if they do not register themselves in the NHTDZ and ETDZ. A software company in Guangzhou claimed that it now enjoyed exemption from the revenue tax. I asked the entrepreneur how he obtained the exemption. He told me that the TV news reported the Guangzhou municipal government now put a premium on the software industry. If a company fulfilled certain specific conditions, the company could actively contact the Commission of Science and Technology. Hence, he actively contacted the Commission. Since then, he was invited to participate in some meetings concerning the industry, and the Commission actively advised him to apply for exemption from the revenue tax.[57]

Why did only one of my surveyed firms obtain this special treatment in Guangzhou, when other cases should have been eligible for it? When I told this information to another entrepreneur, his response was, "if so, the government should do a promotion, and let me send out thousands of e-mails to inform other people." I asked him why many entrepreneurs seemed to know so little about government policies or did not believe those policies. He replied, "the businesspeople are too busy to care about it;

[57] Interviewee 38.

you know, our state's policies always change."[58] His comment was pertinent. Most of other entrepreneurs shrugged off the government's preferential policy when they made decisions. On the other hand, the transparency of the government policy and policy implementation was not high enough to keep enterprises well informed.

To be sure, the large enterprises tended to be better informed than the small ones. In Beijing, for instance, many software developers need to pay VAT. The rate was stipulated as 17%, which was quite high for the software industry. Unlike other industries that can compute the taxable income after deducting the cost of materials, software production has no significant cost for production materials. The most expensive cost is the salary of programmers. But the tax agent only counts the salary cost as about 800 yuan per employee, while their salaries are over 3000 yuan. Furthermore, the fixed capital investment for hardware was not counted as a cost for deduction. In order to alleviate the burden borne by the industry, some Beijing newspapers revealed in May 1999 that the Beijing municipal government would cut the rate from 17% to 6% specifically for the software sector. Meanwhile, I was interviewing two entrepreneurs of medium-sized software companies. I asked them to comment on the news. They responded with reservation, stressing that it was impossible in practice. However, when I talked with interviewees of Ufsoft and CSC, they had already been acquainted with this issue and were certain that it was true. Indeed, the Beijing government formally later promulgated the policy.

The above episodes reflect the fact that there was serious "information asymmetry" among the enterprises. The larger enterprises apparently have a greater advantage to directly gain information. At the same time I refute the sociologist notion

[58] Interviewee 42.

that personal ties could help to save the cost of information collection and are efficient. The above episodes show us that it is not necessarily true. The publicly accessible information is not necessarily unreliable, whereas the indirect information from personal ties is not necessarily more reliable. If one depends upon it too much, one may miss more opportunities. The personal ties have not necessarily saved the cost but possibly exacerbated the information asymmetry for those who rely upon the ties.

Tax and Fee Management

Most of the preferential policies are concerned with taxes. The tax affairs are the major interface of the state and private business. The specific tax policy is adopted as leverage by the state to sway the behaviour of the entrepreneurs. But the effect varies from one to another industry and varies from small to large enterprises. It is determined not only by the policy itself but also by how it is implemented.

In general, large private enterprises bear less of a tax burden (including fees levied by various state agencies) than small private enterprises in terms of the percentage of their sales.[59] In the first place, this is caused by the fact that the large firms tend to enjoy more preferential tax policies. To the contrary, the small firms not only pay the ordinary tax rate or even excessive taxes but also bear more extra arbitrary fees levied by various state agencies. If a firm is registered as either a wholly individually-owned enterprise or a partnership enterprise, the owner of the firm is taxed twice — a personal income tax and corporate income tax. The large firms are usually

[59] According to the survey done by the Asia Pacific School of Economics and Management at the Australian National University with the assistance of the China Centre for Economic Research, Peking University in 1999. See *A Technical Report. China Private Enterprise Study* (January, 2000), Chapter 6: 6.

limited companies that do not need to pay duplicate taxes. The large firms also tend to be better able to avoid state predation. On the one hand, they usually have a better relationship with senior authorities of the state. On the other, the tax office and other state agencies prefer to target small firms. Why?

Small firms, including *getihu*, usually do not have a well-established accounting system. Even when they do, the state supposes it to be unreliable. Hence, the tax agent usually levies a fixed tax on the small business firms. The amount is calculated by tax officials based on their estimated sales. In other words, no matter how much one really earns in each month, one pays the same amount. This practice aims to maintain stable revenue for the state, but it gives leeway and a pretext for the tax collector to "harass" the small businesspeople if necessary. Whenever the tax agents find it possible that the planned tax quota cannot be met or they are pushed to fulfil an extra quota, they start to squeeze money from the small business first in the name of a "tax examination." Without being required to keep a proper accounting system, the small business firms indeed tend to under-report their sales or keep no accurate bookkeeping records. The tax officials would not find it difficult to dig out any fault of the businesspeople and consider it tax evasion, for which cause the tax officials can levy a heavy fine. The small firms are the primary targets of the attack also because they are large in number and accessibility to them is better. The retail and food shops are the major victims of this state predation. As they are geographically open and more congregated, not only the tax bureau but also other state agencies prefer to extract money from these sectors.[60]

[60] This comment was provided by an IT entrepreneur who also invested in restaurants – Interviewee 52.

It should be noted that while the planning system in most respects has been abolished or diluted in China, the clout of it in taxation has never diminished. The state tax agents still need to accomplish assigned tax quotas. Hence, many enterprises are not taxed in accordance with how much they earn. To be sure, the tax agents cannot abuse their power utterly without regard to laws. Limited companies with a better accounting system tend to avoid the "harassment" and pay taxes according to the laws. This does not mean that the accounts of large firms are accurate and reliable, but the opportunity cost for digging out the faults of these companies is higher. They therefore are not the first targets of attack.

The phenomenon of excessive and illegal levies was not intensively reported among my interviewees, even though most of them run small firms. But it should be qualified that some entrepreneurs disregarded this issue because they left all matters concerning tax and fee collections to the accounting staff to settle and took various levies as an ordinary cost of business operation. But at least it reflected that it was not serious inasmuch as it drew their attention. The status of most of them as "companies" would be one reason they avoided excessive levies. Moreover, the companies in the NHTDZs and ETDZ were protected from state predation. All told, thus, these well-educated entrepreneurs were not the top priority for the tax officials to bully. However, confrontation remained inevitable during particular incidents. In 1998, the Asian financial crisis erupted. During the crisis, the government imposed more pressure upon the local state agencies to keep up their locality's economic performance. The premier, Zhu Rongji, called upon localities to try their best to achieve at least an 8% growth rate that year. The state tax machinery was also assigned equally heavy missions. In

Haidian, the Bureau of Industry and Commerce Management (BICM) was assigned to complete an extra-tax quota for 10 million yuan. As a result, the Bureau managed to accomplish the mission by selectively charging 1,000 enterprises 10,000 yuan per each.[61] An entrepreneur who was running a promising IT company in Haidian revealed to me that during the crisis, the tax bureau dispatched an inspection team to examine his company's accounts. The team left no stone unturned in search of a "mistake" committed by the company, but failed. Yet, the team trumped up a charge that his company failed to pay VAT after providing an offshore technical service, fining his company hundreds of thousands of yuan. In accordance with the tax regulations, VAT should not be applied to this case. The entrepreneur angrily made a complaint to the team's higher-up. The official knew the fine was groundless, so he shifted to persuasion rather than repression, asking the entrepreneur to pay the fine for the sake of helping the local government to ride out the hard times. The official also compromised by cutting the fine to tens of thousands of yuan. The entrepreneur accepted the compromise because he did not want to take the government to court for this small amount.[62]

To be sure, the official attitude towards thriving companies is less repressive. First of all, they are a burgeoning source of state revenue. Second, their capacity to move to a more favourable locale is higher. However, the state might still ask them for an "extra" contribution, but this is attained by pleading rather than ordering.[63] The enterprises with a high profit rate among my cases did not mind paying an "extra"

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[61] Interviewee 6.
[62] Interviewee 11.
[63] In a piece of newspaper coverage, a celebrated entrepreneur aired that he was very willing to contribute to the state. The chief of tax bureau simply phoned him to plead with him for helping fill up the gap of tax quota, he immediately agreed. See *Zhonghua gongshang shibao* [China Business News], 6 March 1998: 8.

contribution to the state. For one thing, sometimes they regarded it as a donation to the state or society and for another, it could help cultivate a good relationship with the state, or at least avoid unnecessary troubles.

Not all of the surveyed firms were making a big profit. Their response to the taxation thus varied from one case to another. Grumbling usually came from enterprises that were engaged in a trading business. With fierce market competition in recent years, the marginal profits for such businesses have spiralled downward. Even though the VAT and income tax would decrease in response, the revenue tax, which taxed the sales volume, was heavy enough to plague the entrepreneurs. Some entrepreneurs of software companies also complained of the heavy burden caused by the VAT. As noted in the last section, owing to not counting the fixed capital investment as a cost for deductions, the taxable income became too high. The VAT was introduced during the 1994 tax reform. The design of the tax was aimed to cool down the overheated economy after 1992. Hence, it stipulated that the fixed capital investment was not counted as a cost for deduction. As an adverse side effect, it also resulted in discouraging the high-tech companies from investing in technological advancement. The new tax policy, noted in the last section, that was applied to the software industry was intended to mitigate this side effect. Still, some entrepreneurs insisted that the key to resolving the issue should not centre on the rate of the tax, but on how the cost was calculated. As a new policy, it takes times to see the effect of the implementation. As a matter of fact, the local tax agent is a determinant of the consequence.

Interestingly, some software companies among my cases did not pay VAT or already paid the tax at the rate of 6% due to their status as "small taxpayers." These cases were more prevalent among the firms in Guangzhou. A few cases claimed that they just paid a "service tax" in place of VAT (about 5% of sales). Some enterprises registered themselves or were categorised as "small taxpayers" in terms of their smaller volume of sales, and just paid the VAT at the rate of 6% according to the state regulations. However, I found that the sales of these small taxpayers were not really smaller than the regular taxpayers I interviewed. On the other hand, as a cost, small taxpayers were not eligible to provide VAT receipts. Therefore, they would find it difficult to do business with larger customers who needed the VAT receipts for their VAT deduction. However, a small taxpayer in Guangzhou claimed to me that the tax bureau would issue VAT receipts for him and the rate of the tax was only 4% instead of 6%. Yet, his status as a small taxpayer imposed a negative effect upon his company's image. While he was carrying out a joint project with a big Canadian telecommunications company, he sensed that this foreign partner looked down upon his company when the former was informed of the latter's identity as a small taxpayer.[64]

Furthermore, the telecommunications company that had moved from Changsha to Guangzhou, though not categorised as a small taxpayer, claimed that the rate of the VAT for it had been cut to 6% for a couple of years. Probably some local authorities arbitrarily made concessions to the IT industries and others exercised their discretion to categorise some enterprises as small taxpayers so as to boost the IT sector. It is noteworthy that several small entrepreneurs pointed out that the current tax regulations diverge from the real economic situation. If the tax officials really strictly enforced the regulations, all of the small businesses would fold up immediately. Hence, the tax officials connive at tax evasion from time to time in order to help out during the

[64] Interviewee 37.

economic downturn. However, this also gives the corrupt officials a pretext to take bribes. In addition, the tax bureau could easily attain the goal of predation, while the economy turns up, by digging out "faults" from old accounts.

State-Enterprise Coordination and Entrepreneurs' Attitudes towards the State's Role

Although illegal levies were not prevalent among my cases, most of the registered private enterprises among the cases, excluding those registered as collective and foreign-funded enterprises, faced a charge paid for membership of the "Private Enterprises Association." The Private Enterprises Association (PEA) is an intermediary organisation that is supposed to bridge the state with private enterprises, other than the Federation of Industry and Commerce (FIC). The PEA is organised and led by the local BICM, while the FIC comes under the Party's United Front System and has a national-level representative — the All China Federation of Industry and Commerce.[65] The domains of the two organisations do not overlap each other. In other words, if an enterprise is a member of the PEA, it is not of the FIC and vice versa. Usually, big businesspeople are co-opted by the FIC, while the businesspeople of small and medium-sized firms join the PEA.

According to the interviews in Beijing and Guangzhou, the performance of the PEA was much worse than that of the FIC. Only a few of the entrepreneurs were members of the FIC. They assumed positions in the FIC, and the FIC had regular meetings whereby the entrepreneurs could transmit their opinions to the government.

[65] For studies of these two organisations, see Jonathan Unger, " 'Bridges': Private Business, the Chinese Government and the Rise of New Associations," *The China Quarterly*, 147 (September, 1996): 807-14; Gordon White, Jude Howell & Shang Xiaoyuan, *In Search of Civil Society: Market Reform and Social Change in Contemporary China* (Oxford: Clarendon Press, 1996), 184-207.

But this basic function did not exist in the PEA. Most of the private entrepreneurs in this study joined the PEA involuntarily. Each year the BICM conducted an examination of private enterprises, and at the same time the firms are required to pay the membership fee. If the firms do not pay, the BICM holds back their business licences so that the firms cannot engage in business. Hence, almost all of the private enterprises among my cases could not help but pay the membership fee. The amount of the membership fee was not standardised. According to my interviews, it could range from hundreds to thousands of yuan. No one knew the criterion. The BICM's officials seemed to exercise much discretion on this issue.

The income from charging the membership fee seems to be only a compensation to the Bureau's bureaucrats for the loss of the private enterprise management fee that was abolished in 1996. The association seemed to be an inactive organisation. Most of the PEA members among my cases complained that they did not know what the association existed for other than to force them to pay the annual fee on time and to subscribe to the PEA's magazines. The PEA never held meetings or other activities for the members and never actively offered assistance to the members. Only one entrepreneur in Beijing claimed that he considered the PEA his leading authority that could stamp his application to go abroad.[66] Another entrepreneur, who had worked in the PEA before, defended the PEA as helping to protect private enterprises from government infringements, but on the condition that the entrepreneurs had good *guanxi* with the PEA in advance or that they were big businesspeople.[67]

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[66] Interviewee 22.
[67] Interviewee 15.

As the PEA was considered functionless, the entrepreneurs simply regarded the membership fee as a surcharge by the government. Interestingly, two entrepreneurs were able to withdraw from their memberships. To be sure, the PEA is statutorily an association that private entrepreneurs should join of their own accord. It is illegal for the BICM to impose compulsory membership upon private entrepreneurs. In practice, if one is willing to struggle for justice, one may succeed in quitting the PEA. An interviewee in Beijing withdrew from membership by struggling with a BICM official. When the official threatened to hold back his business licence, the entrepreneur fought back by warning that he would denounce the official to the senior authorities if he really did so and argued for his stance was based upon the state's own stipulation that any government departments should not levy illegal fees on enterprises. His endeavour was successful. He withdrew from membership without being sanctioned. He also criticised the tolerance of other entrepreneurs, which emboldened the BICM to intensify its mispractice.[68] To be sure, some of the entrepreneurs in my sample were not aware that membership was not compulsory for private entrepreneurs according to high-level regulations.

Obviously, the PEA failed to play a role as a bridge between the state and private enterprises but was only another predatory state machine. Most of the entrepreneurs seldom sought alternative channels to contact the state. The majority among my cases did not join other intermediary associations. Their full engagement in business was the usual excuse for their indifference to these organisations. Some explained that they could not actively join these organisations unless they were invited

[68] Interviewee 18.

to join. A dozen small entrepreneurs among my cases joined some intermediary associations, including the software trade association, the accounting computerisation association or chamber of commerce for the computer industry. Yet, some of them also complained that the organisations were functionless and unable to represent their interests. Only the big businesspeople had a voice there and monopolised all of the benefits, they complained.

However, a few of the small entrepreneurs were active participants in these organisations. They were even initiators of such organisations, though they still needed to ask for the corresponding government departments to sponsor and lead the establishment nominally. It should be noted that the official participation/intervention in these organisations, as a result, earned no confidence from the "apathetic" entrepreneurs. Nevertheless, this type of intermediary association has been burgeoning since the second half of the 1990s. What actual functions they are playing requires further research, but apparently they are primarily capable of helping to coordinate certain companies within the same industry. To a lesser extent, their opinions can be transmitted to the government. At bottom, according to the findings from my fieldwork, the IT enterprises have not organised themselves well to fight for their own interests.

The problem of pirated software was a typical example. At the Shenzhen Hi-tech Fair held in October 2000, several software companies initiated an anti-piracy campaign and made a public appeal to their counterparts to join a meeting against piracy. However, to the initiators' disappointment, only five of the expected 50 guests showed up for the meeting.[69] Beijing and Guangzhou are two major consumer centres of IT

[69] *Zhongguo jingji shibao* [China Economic Times], 12 October 2000 (Internet edition: www.cet.com.cn).

goods. So both are paradises for pirated software. When I was conducting my fieldwork in these two metropolises, the sale of pirated software was quite visible, albeit it had already gone underground in Beijing. On the streets around Zhongguancun, many non-native-looking people paced up and down and from time to time actively asked pedestrians whether they were looking for software CD-ROMs. They did not hold any CD-ROM disks on hand, and customers needed to follow the peddlers to inside alleys to select and pick the disks. Obviously, the Beijing authorities had cracked down on the sale of pirated software and the activities were being conducted in guerrilla style.

As everything is more liberal in Guangzhou, so too is the sale of pirated software. The software was available at shops. An entrepreneur who was running software chain shops in Guangzhou complained to me that the Guangzhou authorities connived at the sale of pirated software on the condition that the shops concurrently sold a certain proportion of copyrighted software. The reason behind the tolerance was that this was a lucrative business that contributed much to the coffers of the police and the BICM, so they were reluctant to lose this significant source of revenue.[70]

Piracy is threatening the survival of the software industry. As mentioned in the last chapter, one of the interviewed enterprises almost faced collapse under the crush of the pirated software. And this case was only the tip of the iceberg. Many software developers rebuked the government for failing to crack down on the pirated software; on the other hand, the domestic software developers themselves had less resort to the private enforcement of intellectual property rights than their Western counterparts.[71]

[70] Interviewee 31.

[71] But one of entrepreneurs among my cases was appealing to a lawsuit against the infringement of intellectual property rights by his former employee — Interviewee 19.

Some software developers tried their own way, joining hands to fire back by launching a price war against pirated software. Another owner of software chain shops was going to launch such a price war in collaboration with other software developers. Many software packages originally priced one hundred-something yuan were now all priced 28 yuan. Of course, it was a futile attempt. The producers of pirated software do not need to bear the cost of R&D, but the copyright holders do. And the production cost of a CD-ROM disk is merely two yuan. Moreover, as a journalist commented, the consequence of such cutthroat competition is curtailing the software developers' ability to undertake long-term development, because they could not rapidly accumulate sufficient capital for R&D.[72]

While the entrepreneurs grumbled over the government's failure to handle the issue of piracy, they did not anticipate that the government would offer any direct substantial assistance to their industry. What they commonly demanded was that the government should further liberalise the restrictions upon the industry, create a fair environment for competition and improve the infrastructure for the industry. The example of unfairness entrepreneurs that frequently cited was the monopoly of China Telecom and its spin-offs that were unfairly competing with the private sector.

Some entrepreneurs expressed their discontent with other state policies. Despite being a graced entrepreneur, the PC manufacturer in Guangzhou spent much time during the interview condemning the new SOE reform measure, debt-to-equity swap. He denounced the measure as rewarding the misbehaviour of SOEs' management: "the government doesn't care how much the SOEs owe, they don't need to repay the debt. The government further lavishly gives them money without any *quid pro quo*. This is

[72] *Zhongguo jingyingbao* [China Business], 18 January 2000 (Internet edition: www.cb.com.cn).

encouraging enterprises not to keep to promises." The enduring juxtaposition of the SOEs and the private sector, and the undesirable state-private business relationship induced a grievance among certain private entrepreneurs. While they considered themselves to be contributing much more to economic development, they were kept in an inferior status and could not have equal access to resources with the SOEs. They even considered themselves to be subsidising the inefficient state sector. They also sensed that the bloated bureaucratic structure was milking the private sector of its economic surplus. While government officials often pleaded with them for computing technical assistance, they had to be subject to the leadership of these "incompetent" officials. A cynical attitude towards the state was prevalent among these well-educated IT entrepreneurs.

Even though entrepreneurs did not require government support on the supply side, a few of them suggested that the government should bolster their development through the demand side. This opinion all came from entrepreneurs in Guangzhou. It is interesting to note that based in the national capital, most of Beijing's entrepreneurs among my cases embraced a broader vision. They just regarded Beijing as a core to disseminate their market into every corner of the country. They tended to take an offensive strategy to penetrate into various local markets. By contrast, the marketplace of Guangzhou's firms tended to be confined to Guangdong or South China at most. They took a defensive strategy to protect their own market. Hence, some of the Guangzhou entrepreneurs suggested the local government should spur more demand through government procurements and more computerisation of government departments. This finding is interesting in the sense that the Guangzhou entrepreneurs, who commonly agreed that Guangzhou was one of the most liberal and marketised economic regions and had the most institutionalised and reliable commercial environment, urged more state intervention in the IT market.

It was not remarkable, though, that Guangzhou and not the Beijing interviewees put forward this idea. Beijing has been the most computerised city in China. The government has been the top consumer of IT goods there as well. Despite this, the constellation of subsidiaries of the U&RIs in Beijing filled up the top of the selection list for government procurements. The small individually owned IT firms never take account of the possibility of their sharing in government contracts. But this is not the case in Guangzhou, where there are not such a large number of spin-offs. The small IT firms seem to have more opportunities to share in the pool of government contracts.

It should be noted that the government already had formulated a policy line regarding government procurements in which the purchasing order should be placed with local firms if the conditions offered by other firms are not better. In the last chapter, I mentioned that the PC manufacturer in Guangzhou obtained the biggest PC purchasing contract from the Guangzhou government. It should be noted that its rivals included two top domestic PC manufacturers — Legend and Founder. This result was probably credited to the above policy. In the new development policy for the software industry, the central government also stipulates that all state agencies should adopt the domestic computer software provided that the domestic one does not carry fewer functions and a higher price.[73] The newly-founded Tianhe Software Technology Park

[73] See Article 25 of "Detailed Rules on Development Policies of Encouraging Software and Integrated Circuit Industry" issued in October 2000.

under the TSP also promises to offer support to help the software firms at the Park to obtain government purchasing contracts.[74]

Concluding Remarks

The Chinese state now deploys various industrial policies to steer a path of IT development instead of the direct control employed during the era of a planned economy. Yet, the pace of development looks relatively slow vis-à-vis India, albeit its take-off in China was also achieved in a decade. Even though we take the relative deficiency of IT resources and advantage, especially human resources, into account, the Chinese IT industry would probably have made greater strides if there were no institutional constraints left in place by the old politico-economic institutions. And these constraints have included discrimination against private ownership compared to public enterprises.

The "dysfunctional development" accounts for the considerable part of the growth. The spontaneous development of spin-offs and one-step-ahead local policies were indispensable for the industry's rapid growth. To be sure, the positive function of preferential policies should not be exaggerated. Even though Beijing offered less preferential treatment than Guangzhou, Beijing has been the spearhead of high-tech industrial growth. In 1999, the performance of Beijing's NHTDZ was top among all NHTDZs. The three main economic indices of Beijing's NHTDZ accounted for 10% of

[74] See Article 6 of "Provisional Methods concerning Supporting the Software Enterprises in the Tianhe Software Technology Park" issued in August 1999.

the total achieved by all 53 national-level NHTDZs.[75] The geo-economic advantage of Beijing contributed much to the vigorous development.

In sum, the state is more a hindrance than a help to the healthy development of the IT sector, and perhaps to the entire sphere of industrial development. The unreasonable taxation system, the outdated and ideology-ridden corporate regime, inadequate financial institutions, the predatory state machine, the protégé SOEs, the lack of transparency of the state and feeble law enforcement all account for the state's distorted or negative contributions to development. The entrepreneurs' alienation from the state ensues. Although the achievement of socialist marketisation should be credited to the withdrawal of the state from the direct management of economic operations, the state thereafter failed to rearticulate a mechanism to create a "negotiated relationship" with private business. As a result, the state is not yet able to strengthen the entire business sector in collaboration with the state's pursuit of developmental goals. Nonetheless, its collaboration with selected business groups/sectors is burgeoning now.

The "intermediate state" approach to industrial development tends to implement a partial reform to influence economic transformation. The pick-the-winner strategy embodies this type of approach. The big private businesses are now picked by the state to be the backbone of industrial development and to participate in the more influential intermediary associations (e.g. the FIC) and lawmaking (i.e. People's Congress).[76] They

[75] The three main indices are technology-industry-trade revenue, gross industrial output and state revenue contribution. See from *Zhonghua gongshang shibao* [China Business Times], 19 February 2000 (Internet edition: wwwcbt.com.cn).

[76] At the 9th National People's Congress (1998-2002), 80 deputies are private entrepreneurs, including those from the spin-off enterprises. See *Zhonghua gongshang shibao* [China Business Times], 6 March 1998: 5.

become a privileged group, distinct from underprivileged small businesses. They enjoy better access to state resources.

Despite the distinction, the privileged business groups to a certain extent represent all business strata, because they also share some common interests with their smaller counterparts. They have started to initiate their own agenda at the legislative level to fight for the interests of the private sector. The recent National People's Congress's redefinition of the non-public economy as an "important component of the socialist economy" is an outstanding case. The motion to pass this "redefinition" was tabled by a dozen deputies from the private business sector in 1998, and it was then voted on at the session in early 1999.[77] To be sure, the political initiative of the private entrepreneurs as a whole is very limited and so should not be exaggerated, but the state's responsiveness to requests from the business circle has apparently been enhanced.

The enhancement of state responsiveness is also reflected by an array of recent measures to nurture high-tech industrial growth. For instance, in order to facilitate the prosperity of the New Economy, the government is drafting an amendment to the Company Law by relaxing restrictions on the forming of limited companies and corporate finance so that private entry into incorporated enterprises becomes easier.[78] It is noteworthy that the growth of IT/high tech industry in China also hastens the reform of the overall economic institutions, similar to what has been occurring in India. A partial industrial reform, in short, helps to trigger the momentum of an enlarged

[77] *Zhongguo qiye bao* [Chinese Enterprise News], 4 June 1999: 5.

[78] See *Zhongguo jingying bao* [China Business], 29 August & 10 October 2000 (Internet edition: www.cb.com.cn).

economic reform. The formulation of industrial policies and the growth of industry are mutually reinforced.

Plate 7.1: The Headquarters of the Ufsoft Group at the Shangdi Information Industry Base.

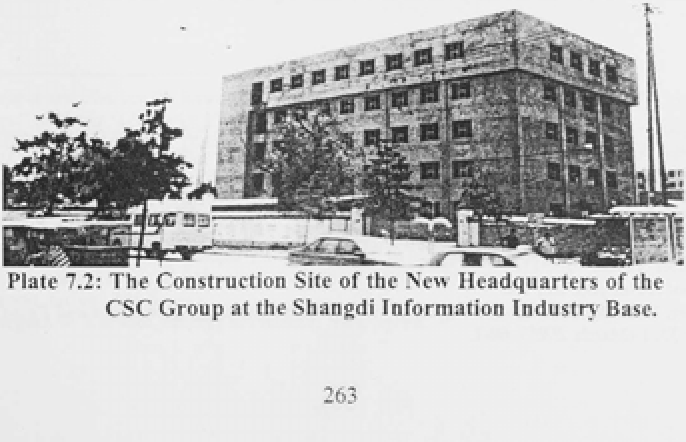

Plate 7.2: The Construction Site of the New Headquarters of the CSC Group at the Shangdi Information Industry Base.

Chapter 8: Conclusion

Private Ownership Matters

The development of a *de novo* private sector as a prescription for economic reconstruction of the countries of the former Soviet bloc has recently drawn scholarly attention.[1] The most remarkable case is Poland, whose *de novo* private sector has played an indispensable role in re-engineering the national economy, which experienced a fast recovery as early as 1995. The private sector has accounted for the lion's share of the Polish GDP and labour force since the mid-1990s.[2] It is paradoxical to note that pessimism was dominant among the discussions of Poland's economic prospects throughout the 1980s and early 1990s. Its privatisation process was the slowest among these former communist countries, as the Polish government did not implement the privatisation programme in earnest from the outset, even though privatisation was upheld as the highest commandment for restructuring state-ownership-dominated economies. Probably it was a blessing in disguise. Without a deliberate plan, Poland's private sector has been prospering and has now become one of the largest in the region. At the same time, Poland still possesses a relatively large state sector.[3]

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[1] See Krzysztof J. Ners, "Privatisation (from Above, Below, or Mass Privatisation) versus Generic Private Enterprise Building," *Communist Economies & Economic Transformation* 7, 1 (March, 1995): 105-116; Grzegorz W. Kolodko, "Transition to a Market and Entrepreneurship: the Systemic Factors and Policy Options," *Communist and Post-Communist Studies* 33, 2 (June, 2000): 271-293; Jan Winiecki, "Crucial Relationship between the Privatized Sector and the Generic Private Sector in Post-communist Privatization: Determinants of Economic Performance," *Communist and Post-Communist Studies* 33, 4 (December, 2000): 505-515.

[2] Krzysztof J. Ners, op. cit., 106.

[3] Ben Slay, "The Polish Economic Transition: Outcome and Lessons," *Communist and Post-Communist Studies* 33, 1 (March, 2000): 60-1.

The awkward predicament of privatisation programmes among the former Soviet and East European countries is always taken as counter-evidence against the conventional faith in private ownership, especially compared with the "no-outright-privatisation" policy of China.[4] However, the at times miserable experience of privatisation only means that the task of the transition can be arduous and time-consuming. There is no easy method, for instance, to clarify the ownership structure of SOEs, especially the large ones, which are deeply entrenched in the pre-reform system.

As Jan Winiecki points out, cultivation of private ownership outside the old system is more feasible and easier for the state to rapidly hasten economic recovery and growth. It is more feasible to create institutional conditions for the *de novo* private sector than to re-organise the old state sector, as the latter entails more state input into the restructuring.[5] By contrast, with its flexibility and better responsiveness to market signals, the small- and medium-sized private enterprises tend to perform far better than the state sector and privatised SOEs and are better able to absorb the surplus labour released by the old sector. At the same time, the growth of a *de novo* private sector also helps create a healthy and competitive environment to spur the reform of the state sector.[6]

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[4] For example see Thomas G. Rawski, "Progress without Privatization: The Reform of China's State Industries," in Vedat Milor (ed.), *Changing Political Economies: Privatization in Post-Communist and Reforming Communist States* (Boulder: Lynne Rienner, 1994); Cui Zhiyuan, "Zhongguo shijian dui xingudianzhuyi zhengzhi jingjixue de tiaozhan" [The Challenge of Chinese Practice to the Neo-classical Political Economy], *Xianggang shehui kexue xuebao* [Hong Kong Journal of Social Sciences], Special Issue (July, 1995): 1-33; Edward S. Steinfeld, *Forging Reform in China: The Fate of State-owned Industry* (Cambridge: Cambridge University Press, 1998); Wu Yu-shan, "Huigu Zhongguodalu chanquan geige" [A Review of Property Rights Reform in Mainland], *Xianggang shehui kexue xuebao* [Hong Kong Journal of Social Sciences], 14 (Summer, 1999): 175-199.

[5] Jan Winiecki, op. cit., 508-9.

[6] Ibid; Grzegorz W. Kolodko, op. cit.; Krzysztof J. Ners, op. cit.

The liberal Chinese economist, Fan Gang, mentioned in Chapter 4, puts forward a similar argument in terms of "incrementalism" to account for the "success" story of the Chinese reform: the non-state sector, which refers to the new economic sector established outside the state planning system, has contributed the most to the post-Mao economic reforms. It is fortuitous that both Poland and China took a similar path of development. But it is absolutely not fortuitous that both countries have been successful.

In China, the domestic non-state sector — the privately-owned, township-village and *minying* technology-based enterprises — is the counterpart of the *de novo* private sector in Eastern Europe. These non-state enterprises are now considered the same as "private" enterprises popularly on the mainland. However, a number of scholars are convinced that in China many of these enterprises, especially among the township-village and *minying* technology-based enterprises, are ***neither*** private ***nor*** semi-private due to their collective and state ownership in registration, and their association with local state authorities.[7] But some of them also agree that these enterprises share most features of generic private enterprises.[8] They are independent of state planning and have not received state budgetary investments. These enterprises are headed by entrepreneurs who have a high degree of autonomy in enterprise management and in disposal of the enterprises' property. The entrepreneurs enjoy the majority of the residual claims to the enterprises. Although many of these enterprises are claimed to have been initially

[7] See Wang Xiaoqiang, *Mozhe shitou guohe: Zhongguo geige zhilu* [Crossing the River by Groping for Stones: The Path of China's Reform] (Hong Kong: Oxford University Press, 1996); and Qiwen Lu, *China's Leap into the Information Age: Innovation and Organization in the Computer Industry* (New York: Oxford University Press, 2000).

[8] For example, see the case studies of non-state computer enterprises in Lu's work, ibid.

funded by state institutions, the state or their parent institutes have not genuinely put considerable material or capital resources into the business. The enterprises utilise some state facilities and resources, but they pay for that, not without any *quid pro quo*.[9] They are really the personal property of the co-founders of these enterprises. They registered their firms as "public" enterprises in part because the state did not allow the operation of private enterprises until 1988. Even after that date, the infant private enterprises were discriminated against by various state agencies until the end of the 1990s. Now these enterprises are trying to clarify their property rights either by incorporation or shareholding transformation.

To be sure, as foreshadowed in Chapter One, private enterprises should not be confined to the enterprises funded by private capitalists and run by investors. In some cases, the state funds the development of private enterprises. Some remarkable examples are the enterprises set up at state-sponsored "enterprise incubator" zone by domestic and overseas university graduates. Many other foreign governments similarly sponsor young entrepreneurs to establish start-ups in the IT industry. The emergence of *minying* technology-based enterprises does not lead to a conclusion that private ownership does not matter, but it demonstrates an alternative path for nurturing private enterprises.

Networking of the IT Private Enterprises

Despite special features of the industry, the IT sector shares a lot of common institutional issues with other private enterprises. According to my findings, most IT entrepreneurs among my cases have by formally registered their firms as private

[9] See such cases from Lu's work. Ibid.

companies in accordance with the Company Law and rid themselves of the institutional control of a *guakao*. The entrepreneurs in my sample are no longer confronted by the common constraints previously faced by all private enterprises and no longer survive through official patronage. They are enjoying a high degree of autonomy and some have even been highly mobile, disregarding the enduring constraints imposed by the household registration system.

However, the IT entrepreneurs also face specific problems with respect to the special features of the IT industry. Alongside the state imposing a regulatory regime over the industry, some of these entrepreneurs need to go through more administrative and supervisory procedures and even face the problem of their businesses' legitimacy, as some policy areas are either still ambiguous or are pending state regulations. In this regard, it is advantageous for the entrepreneurs to keep close and good relations with the officialdom-in-charge. On the one hand, it helps them to keep abreast of government information. On the other, the entrepreneurs may try to lobby for a policy in line with their interests. In light of the government setting great store by the IT industry, IT entrepreneurs tend to bet their stakes on a marketisation policy line of the Party that is supposed to further liberalise control and open more areas to the private sector in the future.

Marketisation counts for much with regard to the developmental autonomy of the private enterprises. Marketisation is dampening the magnitude of individual linkages. Exclusive linkages are reduced and becoming less influential. Marketisation in the sense of network analysis implies expansion and opening of webs of personal interchange. It opens opportunities for more and varied market participants, including investors, entrepreneurs and consumers, with the scale of business enlarged. And the opportunity of manipulation by a few business participants decreases accordingly.

This process of marketisation of the Chinese IT sector can be outlined in terms of a transition from a government-demand-driven market to a business- and populace-demand-driven market. The process witnesses a decline of exclusive official linkages. The enterprises are relentlessly exploiting new markets for their products, and sales to government cannot satisfy this demand. The emergence of a business- and populace-demand-driven market obviously lessens the dependence of IT enterprises upon state institutions. It can be argued that during this transition, the state sector and all of the spin-offs from various state institutions do not miss the chance to compete for benefits so the smaller private enterprises gain no edge in their access to resources. Despite this, the private sector has not lost the cutting edge in competition in this very marketised sector. In fact, the state sector also seeks partnerships with private firms in light of their better intellectual resources. In this study, the collaboration between software companies and state-owned book publishers provides an example. Despite the greater resources held by the state-sector partner, the autonomy of the private partner does not dwindle, because both sides come to terms of their own accord. Above all, the key to autonomy is the diversity of market participants, giving the private entrepreneurs more choices and bargaining power.

This is not to deny the existence of exclusive linkages and even of patron-client relationships in some sectors of the IT business, such as in the areas where state policy is vague or immature, and those areas where there is a lack of marketisation, like the core business in the telecommunications industry, which is monopolised by a couple of the state-owned companies. Derivative businesses need to depend upon them, for example ISP and Internetphone. However, those enterprises that depend too much upon exclusive and clientelist ties are weak enterprises. Moreover, fierce business competition is not absent among the dependants. In this regard, I want to reiterate a hypothesis — that entrepreneurs tend to want to both reduce dependence and exploit the advantage of retaining important personal ties.

Successful enterprises tend to be able to diversify their business linkages so as to minimise the risk of depending too much upon specific linkages. It should be noted that those business areas that are dependent on a state monopoly firm tend to be less developed and to be unable to expand their scale in the marketplace rapidly. Among the IT private entrepreneurs, they usually agree that the more market participants, the more development in the IT industry. They compare the current development stage of the industry to "making a pie" — what the IT enterprises should do is to make a bigger pie, not to cut and divide the pie. Hence, it is desirable to involve more participants in the business. To pursue a monopoly profit does not benefit the enterprises and the industry in the long run. Hence, most of the private entrepreneurs do not strive for exclusive linkages so as to seek "rent."

The bigger private enterprises are better able to diversify their linkages and minimise the risk-taking. David Wank suggests that the bigger a private enterprise became, the more important bureaucratic support became to it and that clientelist ties become more salient between big entrepreneurs and government officials. My findings do not attest to his hypothesis. In the first place, my cases suggest that small IT entrepreneurs also rely upon official ties to promote their businesses. Moreover, the degree of dependence is not lower than their bigger counterparts, because the infant enterprise usually lacks diversified linkages so that the key official ties become relatively more significant. On the contrary, the bigger private firms tend to have cultivated diversified linkages and seldom rely upon one specific linkage. Probably the big business ventures demand more bureaucrat-controlled resources; but, owing to their rising social status credited to their economic contribution, the bigger entrepreneurs tend to have better bargaining power to secure bureaucrat-controlled resources, like land and bank loans. The small IT entrepreneurs also need these resources, but their accessibility to them is very low. The so-called bureaucrat-controlled resources are not so scarce as to be invaluable, however. Notably, too, local officials also want to release these resources to the better performing private enterprises to boost the local economic growth. Furthermore, inter-regional competition de-monopolises the access to them.

Wank's hypothesis is devoid of a broader networking analysis, not encompassing a cross-sectoral, macro and "demand side" analysis. First of all, Wank's study only focuses upon one sector — the trading industry, and so it provides no comparative analysis. Although mine is on the IT industry, it contains several sectors that have different circumstances that can be compared. In addition, Wank's analysis does not weigh the comparative advantages and consequences of different networking strategies, even though this would be significant for us to judge the magnitude of exclusive and clientelist ties. Wank also disregards the impact of resource re-allocation after economic development upon the state-business relationship.

Furthermore, Wank's hypothesis only lies in a "supply side" analysis in which it is implicitly assumed that the growth of an enterprise is only determined by the production inputs that are provided by limited suppliers. He did not take into account the role of consumers, downstream buyers and producers, and even the local governments that compete with each other for developing local economies. His argument was tenable in the 1980s when a seller's market was dominant. However, with the advent of a buyer's market in the 1990s, it becomes questionable. It is noteworthy that Wank ignored the emergence of a buyer's market inasmuch as he did not agree that the post-Mao reform has created China real marketisation. On all these counts, this study of the IT industry shows that Wank's hypotheses are untenable.

I do not argue that all marketplaces have become buyer's markets. Some areas, like real estate and financial and investment businesses, entail rent-seeking behaviour. To be sure, these are not areas of business where the generic private sector can operate. They are usually sources of profit-seeking of bureaucratic capitalists.

Embeddedness vs. Disembeddedness and Path Dependence

The foregoing discussion of networking leads us to the issue of embeddedness and disembeddedness. In terms of economic transformation, embeddedness is usually understood as a changing economic institution embedded in enduring social and cultural institutions, plus political institutions in the case of China. By contrast, disembeddedness refers to separating the economic institution from the social, cultural and political institutions. It should be recognised that both embeddedness and disembeddedness usually occur concurrently during economic transformation. Sometimes, whether we define a process as embeddedness or disembeddedness depends upon our perception of it. For example, AnnaLee Saxenian argues that the success of the IT industry in Silicon Valley should be attributed to special informal social networks among IT enthusiasts who circulate IT information via after-working-hours social life. She accedes to the thesis of a "social embeddedness of economic life."[10] But I can alternatively define it as an "economic embeddedness of social life." In fact, these IT enthusiasts extend their working hours informally into their leisure time. Economic life invades social life.

After all, there is no pure process of embeddedness and disembeddedness in the economic transformation. What we should focus upon is to see which one is prevailing in the tug of war. Espousers of the school of "embeddedness" usually substantiate their argument by demonstrating the persistence of social and cultural institutions in shaping economic life, or demonstrating the gap between real life and the ideal-typical model. I suggest this is a "static" approach, as against a "dynamic" approach, which focuses upon the development direction of the changing process. What I am concerned about is the relative shift of the institution. I do not cling to the ideal-typical model that may never be attained in the future. In this sense, for instance, Wank seems to regard the emergence of *minying* enterprises as "embeddedness," because he judges that this category of enterprises cannot be distinguished as public or private if gauged in terms of the ideal-typical model.[11] But in the view of the "dynamic" approach, this category of enterprises is a stepping stone to achieve a greater clarity of property rights in the special context of socialist China. In short, only the "dynamic" approach can help

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[10] AnnaLee Saxeian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128* (Cambridge: Harvard University Press, 1994), 29-57.

[11] The growth of *minying* enterprises is a complicated phenomenon, for which I have given an account in this dissertation. Wank's account is too thin to make an appropriate judgement. See David L Wank, *Commodifying Communism: Business, Trust, and Politics in a Chinese City* (Cambridge: Cambridge University Press, 1999), 207.

account for the substance of the economic transformation. Arguments of the "static" approach are sometimes self-evident, but seldom show the dynamics of change.

To find which process, embeddedness or disembeddedness, is prevailing, I tried to trace the development trend of my sample of private entrepreneurs and their enterprises chronologically. My findings, as discussed in Chapters Five and Six and foreshadowed in the last section, substantiate that disembeddedness is prevailing, albeit embeddedness has not disappeared. The economic rationale increasingly dominates the business behaviour of these private entrepreneurs, even though they are embedded in various rhetorical justifications which are aimed at conforming to the notion of socialism, such as justifying the depersonalised status of legal person, the socialist nature of the shareholding transformation and *minying* against *siying* in enterprise labelling.

With the liberalisation and marketisation policy of the post-Mao Chinese state, these entrepreneurs are disembedded from various old institutional controls. The business linkages between the private and the state sector become ever more business-oriented. Informal ties persist, but it is ever more based upon "professional trust." To pursue long-term development, the private enterprises are also rationally disembedded from entrepreneurial familism, which has been considered a long-lasting cultural feature of Chinese enterprises. Even though the state is imposing a regulatory regime upon the IT industry, no one expects that it would take the industry back to the planning era.

"Embedded liberalism" in Western society has not really come into being, Hannes Lacher argues, because the foundation of the logic of the market has not been rooted out.[12] This argumentation could be transplanted to China: when the logic of the market is introduced into China, disembeddedness must be the trend of development. To be sure, this development must vary from the Western or the ideal-typical model. There is a misconception that the disembeddedness is a process of perfect convergence with other market-oriented societies.

The variation should be attributed to the problem of path dependence. The theory of "path dependence" is sometimes confused with that of "embeddedness," because the former is often mistaken as entailing an institutional inertia.[13] In fact, the notion of "path dependence" only denotes that the past decision-making/institutions significantly limit the choices of subsequent decision-making/institution building. For example, the household registration system impedes non-native urban entrepreneurs from forming family firms. State-owned book publishers with traditionally good connections with the state's education system become the most desirable partners of education software companies. But it does not follow that the institution is not evolving based upon a rational profit-seeking motivation.

In addition, it is not necessarily the case that different paths must point in different directions. In other words, someone can choose several different paths but still walk in the same direction. Of course, the paths are not uniform. Some of them are difficult; others are easy, probably short cuts. For example, the development of the private economy in China, as discussed in Chapter 3, is determined by the historical path of the Party policy towards the private sector. This path of development led to a

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[12] Hannes Lacher, "Embedded Liberalism, Disembedded Markets: Reconceptualising the Pax Americana," *New Political Economy* 4, 3 (November, 1999): 345.

[13] For example, see Hongying Wang, "Informal Institution and Foreign Investment in China," *The Pacific Review* 13, 4 (2000): 548.

non-straightforward revival of the private sector and produced a "variant" version of private firms, *minying* enterprises. The Party policy also stifles a swifter development of a private IT sector compared with India, as I argued in Chapter 7. However, above all, the trends of IT development that rely upon the private sector remain similar in both countries. On the other hand, the relatively successful revival of the private sector in China and Poland compared with other former communist states underlines the historical paths of these different countries, among which both China and Poland had a less developed state sector and planning system in the pre-reform era.[14] Even so, it does not follow that other former communist countries should repudiate a strategy of spurring the growth of the private sector, nor does it follow that China and Poland should forfeit the privatisation of the state sector. Gradual and small-scale privatisation has in fact been proceeding in China.

Impact of the Growth of the Private IT Sector upon Transformation

This study of the private IT sector does not represent the experience of all types of private enterprises. IT is one of the most marketised of China's sectors, to the largest extent ridding itself of the planning system and being influenced by global IT production and markets. But it nonetheless demonstrates the degree of impact of the market upon industrial transformation and upon political and social relationships — which is one of the purposes of this study. Market forces do not penetrate into every aspect of social life. But once they enter, their impact is profound. Under the pressure of marketisation, the IT entrepreneurs require that China's economic institutions and

[14] I share this argument with Jan Winiecki, op. cit., 514.

practices increasingly live up to international standards. By the same token, this group of entrepreneurs belongs among the enthusiasts who anticipate an early accession of China to the World Trade Organisation, which is supposed to prompt the country to adhere to the international market system.

The IT industry is largely managed by young entrepreneurs. This new generation of entrepreneurs disengages from any stereotyped business tradition and culture. Facing fierce competition, they have to be innovative and dare to change the established institutions. By the same token, these young entrepreneurs are better able to learn and absorb new and foreign modes of management and technology. The sector is a testing ground for various new ideas and methods such as utilisation of venture capital to finance an enterprise. As a result, the sector *per se* is a vanguard in circumventing the institutions that for a long time stifled the development of the private economy.

In a different sense, too, the introduction of information technology is profoundly changing socio-economic relationships. For instance, the development of the Internet and e-commerce weakens the magnitude of *guanxi* ties, but create webs of impersonal networks among people from distant regions. In this respect, the new information technology is beginning to significantly change the mode of business transactions, just as is beginning to occur in the West.

The IT sector accounts for the majority of high-tech enterprises, which as a whole have been standing at the forefront of Chinese industrial advancement. Through this high-tech industry, the Party started to show respect for private property rights, because it is comprehensible to Party leaders that the property rights structure is closely correlated with the performance of the IT/high-tech enterprises. Hence, the industry has always been a pilot site of property rights reforms. The Party policy towards the high-tech industry is driving the overall liberalisation of the private sector. Several deregulation measures, such as the amendment to the Company Law noted in Chapter 7, are aimed primarily at bolstering the high-tech industry, and other private enterprises share in the benefit. Hence, the IT/high-tech industry has become an engine to hasten the development of all private enterprises.

Obstacles to Being a Developmental State

Peter Evans categorises India as an intermediate state, in which it is hard to describe its features in unambiguous terms, because it lacks a consistent performance within the entire state structure. This is also true for China, and there exist numerous inconsistent and contradictory scholarly descriptions of different parts of the Chinese state. The Chinese state shares most of the features of the intermediate state.

This dissertation has attempted to give an account of the state-business relationship through the lens of IT industrial development. In Chapter 7, I concluded that India enjoys a marginal advantage in that its politico-economic institutions are better able to facilitate the growth of the private IT industry. Despite this marginal advantage, the two countries are similarly operated overall by bloated, inefficient and corrupt bureaucratic machinery. As an intermediate state, though, the above image may not be applicable to every aspect of the state. In the area of the IT industrial development, the image and performance of the concerned government departments are relatively better. The administrations of the New & High Technology Development Zones (NHTDZs) and of the Commission of Science and Technology present a better impression to my interviewees, even though they are not helpful to every firm. Occasionally, these administrations actively nurture certain potentially good companies.

At the level of policymaking, despite involving bottom-up spontaneity, the state has adopted an appropriate strategy to unleash the rich resources of universities and research institutes (U&RIs) in high-tech industrial development. The state aptly allows the spin-offs from the U&Rs to establish semi-private science and technology enterprises that have demonstrated a better performance than the traditional SOEs. The state also set up separate NHTDZs to nurture the infant industry so that it can develop in an environment that is relatively insulated from the old state institutions. Supportive policies are also adopted via taxation and demand-side measures. Apart from the protection, the government tries to create a competitive tender system for government procurements to ensure domestic rivalry, which is important to upgrade the technology of the domestic sector.[15]

Unfortunately, though, owing to a weakening capacity, different parts of the state bureaucratic machinery fail to coordinate well with each other at the level of implementation. The state gives no sufficient support to financing IT, or to law enforcement of intellectual property rights or to the establishment of infrastructure. Considerable state resources have been siphoned off to salvage numerous moribund SOEs in past years. To exacerbate the situation, the good performance in one part of the state machine is offset by bad business operations in other parts. The predatory aspects of the state machine still persist in an intermediate state. It is especially the case in China, because its gigantic bureaucratic structure has never been downsized, not as the

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[15] See this viewpoint from Michael Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990), 662.

Party reformist leaders planned, and, indeed in some sectors the size of the bureaucracies is snowballing.[16] The problem is exacerbated as the growing layoffs from the SOEs are in part absorbed by the state administration. Currently, the IT sector is not facing onerous problems vis-à-vis predatory government organs, and is in fact enjoying preferential treatment and a higher marginal profit. The degree of the state's responsiveness to the sector's demands is apparently higher. However, these factors may not persist evenly in the future.

To settle the above diverse issues — e.g. on intellectual property rights and piracy — creation of a "negotiated relationship" between the state and the business sector is imperative. However, the state still clings to its obsolete role of leadership over enterprises, when it now needs to re-define the relationship after the disintegration of the *danwei* system. As a result, deficiency of communication between the state and IT entrepreneurs is evident.

Despite the political apathy among the entrepreneurs, they sense that the sustainability of their business's development highly depends upon an efficient, stable, reasonable, predictable and unambiguous politico-economic system. Today, the entrepreneurs from time to time need to rely upon informal ties (probably corrupt ones) to tackle the problems caused by defect-ridden institutions. Even though the entrepreneurs can either enjoy benefits or avoid unreasonable treatment through tax evasion and fabrication of registered capital and partnerships, they understand this involves a potential danger that their "misbehaviour" will be disclosed. The owners of fast-growing private enterprises, which are the focus of media attention, especially try

[16] See Hu Jiayong, "Woguo zhengfu guimo weishenme jixu pengzhang?" [Why does the Scale of Our Government Continue to Expand?], *Gaige* [Reform], 90 (March, 1998): 87-92, 103.

to avoid being "the lead bird that is shot down once it takes off."[17] They prefer to run their business in full compliance with a formal institution so that they can pay full attention to their normal business operations. However, sometimes they have no option but to act illegally because some state agencies did not act in compliance with overt laws and regulations, or some policies or measures are *per se* unreasonable and unfeasible. Although this study is not concerned with the political implications of the growth of the private economy, I suggest that greater political participation by entrepreneurs is essential to tackle this issue. Only in a coordinated and negotiated relationship between the state and the business sector will the Chinese state even begin to come close to being a developmental state.

Last but not least, this dissertation has juxtaposed two arguments that at first blush seem opposite to each other: arguing for the overwhelming impact of market forces upon economic transformation on the one hand, but recognising the substantiality and magnitude of informal ties and state participation on the other. Arguing for both sides of an issue is mutually excluded in usual academic argumentation, I do not subscribe to this tradition. The existence of business-oriented informal ties does not counteract the tremendous impact of marketisation, nor does the state's participation in economic transformation. In a neo-statist perspective, the state matters not because of its high capacity to intervene in the economy. The role of the state needs incessantly to

[17] It is often commented upon that most private entrepreneurs dare not make their firms too large and striking, because the firms easily become the target of attacks for various reasons. This is compared to shooting down birds that attempt to take off (*paoda chutouniao*).

change over the process of the transformation. A developmental state is a state that can flexibly and appropriately adjust itself to different stages of economic development.

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Appendix I: List of Interviews

Beijing

	Date of Interview	Position	Enterprise
Interviewee 1*	11 May 1999	Manager of Enterprise Planning Department	PC Manufacturer
Interviewee 2*	14 May 1999	General Manager	PC Manufacturer
Interviewee 3	2 June 1999	Legal Representative	Advertising Co.
Interviewee 4	3 June 1999	Sales Manager	Pharmaceutical Co.
Interviewee 5	5 June 1999	Manager	Drug Shop
Interviewee 6	8 June 1999	Executive Manager	Computer Hardware Dealer
Interviewee 7	8 June 1999	General Manager	Software Co.
Interviewee 8	9 June 1999	CEO	Software Co.
Interviewee 9	14 June 1999	Assistant to President	Ufsoft Group
Interviewee 10	15 June 1999	Manager of After-sales Service Department	Software Co.
Interviewee 11	16 June 1999	Vice General Manager	Software Co.
Interviewee 12	18 June 1999	Assistant to President	CSC Group
Interviewee 13	22 June 1999	General Manager	Software Co.
Interviewee 14	23 June 1999	General Manager	Software Co.
Interviewee 15	24 June 1999	Manager	Food and Beverage Dealer
Interviewee 16	28 June 1999	Chief Editor	Sparkice
Interviewee 17	29 June 1999	Manager	Software Co.
Interviewee 18	30 June 1999	General Manager	Software Co.
Interviewee 19	5 July 1999	General Manager	Software Co.
Interviewee 20	5 July 1999	General Manager	Light Aircraft Manufacturer

Interviewee 21	8 July 1999	General Manager	Software Co.
Interviewee 22	14 July 1999	General Manager	Internet Co.
Interviewee 23	15 July 1999	General Manager	Software Co.
Interviewee 24	20 July 1999	Managing Director cum General Manager	Pharmaceutical Co.
Interviewee 25	21 July 1999	General Manager	Land Property Co.
Interviewee 26	21 July 1999	General Manager	Internet Co.
Interviewee 27	27 July 1999	Manager	Software Co.
Interviewee 28	28 July 1999	General Manager	Internet Co.
Interviewee 29	4 August 1999	Manager	Software Co.

* Interviewees 1 & 2 are from the same enterprise.

Guangzhou

	Date of Interview	*Position*	*Enterprise*
Interviewee 30	7 October 1999	General Manager	Telecommunications Co.
Interviewee 31	11 October 1999	General Manager	Software Co.
Interviewee 32	14 October 1999	Vice General Manager	Software Co.
Interviewee 33	20 October 1999	Manager	Network System Co.
Interviewee 34	21 October 1999	General Manager	Software Co.
Interviewee 35	22 October 1999	General Manager	Software Co.
Interviewee 36	27 October 1999	General Manager	Computer Hardware Dealer
Interviewee 37	28 October 1999	Manager	Software Co.
Interviewee 38	2 November 1999	Executive General Manager	Computer Engineering Co.
Interviewee 39	3 November 1999	Managing Director	Agricultural Technology Co.
Interviewee 40	4 November 1999	General Manager	Software Co.
Interviewee 41	6 November 1999	General Manager	PC Manufacturer
Interviewee 42	8 November 1999	General Manager	Internet Co.
Interviewee 43	11 November 1999	General Manager	Software Co.
Interviewee 44	17 November 1999	President	Technology Research Co.
Interviewee 45	17 November 1999	General Manager	Software Co.

Interviewee 46	19 November 1999	General Manager	Internet Co.
Interviewee 47	21 November 1999	Executive Manager	Computer Hardware Dealer
Interviewee 48	29 November 1999	General Manager	Software Co.
Interviewee 49	2 December 1999	General Manager	Software Co.
Interviewee 50	4 December 1999	General Manager	Internet Co.
Interviewee 51	9 December 1999	Executive Vice General Manager	Software Co.
Interviewee 52	10 December 1999	General Manager	Software Co.

Appendix II: Questionnaire*

Personal Particulars

1. What is your business?

2. Sex

3. Age

4. Education level

5.1. What is the job of your father now?
If he is retired or passed away, what was his job and position?

5.2. What is the job of your mother now?
If she is retired or passed away, what was her job and position?

6. What is your household registration (*hukou*)?
If you were not born here, where is your place of birth?
If you have got the local residency, when did you get it?

7.1. Did you do any other businesses before you started this one?

7.2. Were you hired by any work unit (*danwei*) before you started this business?

Enterprise's Background

1. When did you start the current business?

2. Why did you choose this business?

3. Is your business attached (*guakao*) to any unit?

4.1. As what type of enterprise did your business register at the beginning?

a. Individual (*getihu*)
b. Private enterprise
c. State-owned
d. Limited
e. Shareholding limited
f. Shareholding cooperative

* This questionnaire is translated from the original Chinese version. Most of hypothesised answers listed in the Chinese one are expunged here.

g. Others: ___________________

4.2. Have you changed the registration?
If yes, what is it now? And when did it change?
What are the reasons for the change?

5. How much was the start-up registered capital?
How much is it now?

6.1. How many partners were there at the beginning?
What were their relations with you?
If there were more than one partner (except you), what was/were the relation between you and the most important one/s?

6.2. How many partners are there now?
What are their relations with you?
If there are more than one partner (except you), what is/are the relation between you and the most important one/s?

6.3. Is/are this/these most important partner/s local person/people?

If yes, does/do he/she/they embark on any other businesses or work in other units?
If yes, what does/do he/she/they do?

If no, where do/does he/she/they come from?
Does/do he/she/they embark on any other businesses or work in other units?
If yes, what does/do he/she/they do?

7. How many staff do you hire?
How did you hire them?

8. What are the sources of your capital?

Business Operations, Competition and Linkages

1.1 Do you think your firm has any edge over other average firms in the same industry (except state firms)? If yes, what are they?

1.2. Do you think your firm has any edge over state firms in the same industry? If yes, what are they?

1.3. Are there any disadvantages in the competition with the state firms? If yes, what are they?

2.1. Which type of enterprise is your greatest competitor?
a. Private firm

b. State-owned firm
c. Foreign-invested firm.
d. Township-village collective firm
e. Others: ____________________

2.2. Compared with this competitor, what disadvantages does your firm have?

3.1. What strategies have you adopted to compete?
Was/were it/they effective?

3.2. If you have adopted more than one strategy, which one was more effective?

3.3. What strategy do you think is the most effective in your industry?

4.1. What is/are the most significant business companions of your firm?

4.2. How did you make connections with this/these companion/s?

4.3. Why is/are it/they the most significant companion/s?

4.4. Does/do the companion/s connect customers for you?
If yes, how significant are these connections?

5.1. What are the sources of your customers?

5.2 Among the sources, what proportion of turnover does the most important one constitute?

6. What were the start-up difficulties of your firm?

7.1. Do you plan to expand/develop your business?
If yes, how do you expand/develop?
If no, why?

7.2. No matter whether you now intend to expand/develop, what obstacles do you expect to come across if you do so?

8.1. What are the difficulties of your firms' daily operation?

8.2. How do you tackle them?

9.1. Did your firm get loans from any banks or financial firms?
If yes, what is the type of the financial unit?

Did you need any guarantor?
If yes, what unit/who was the guarantor?

Did the loan need any collateral?

Relationship with Government

1.1. What government departments does your firm contact?

1.2. Which one does your firm contact the most frequently?
Why do you contact it so frequently?

1.3. Is there any government department that is concerned with the development of your business?

If yes, what is it? How is it concerned with your business?

2.1. How many types of taxes and fees does your firm need to pay?

2.2. Do they increase or decrease compared with before?

If increase, why? If decrease, why?

2.3. Does the tax/fee expense of your firm increase or decrease?

If increase, why? If decrease, why?

3.1. Does the government offer any assistance or preferential measures to your firms?

If yes, how did you get it/them?
To what extent could it/they help your firm?
Does the government give it/them to any other firms?

3.2. Have you requested any assistance from the government?

If yes, which department and through which channel to request?
What is the response of the department?

If no, why?

3.3. Is/Are there any government policy/policies that can help the development of private economy?
If yes, what is/are it/they?

4.1. Among the departments you have contacted, which ones give you good impression? Reasons?

4.2. Among the departments you have contacted, which ones give you bad impression? Reasons?

Miscellaneous Questions

1.1. Are you a member of the Chinese Communist Party?

1.2. Are you a member of any Democratic Parties?

1.3. Are you a People's Representative or a member of Political Consultative Conference?

If yes, have you ever proposed any anything about the private economy to it?

If yes, what is it? What is the effect?

2.1. Do you think the private property is legally protected now?
If yes, how?
If no, explain?

2.2. In practice, is the private property protected effectively?
If no, reasons?

3.3. Are you a member of Federation of Industry and Commerce or/and Private Enterprises Association?

If yes, does/do it/they provide you with any assistance?

3.2. How do you describe the functions of these two organizations?

4.1. Have you participated in other social activities?

If yes, do these activities help promote your business development?
If yes, in what aspects?

5.1. Do you have any overseas investment/properties?

5.2. Do you have any overseas family member?